89-894

No. 89-

In the

Supreme Court of the United States.

OCTOBER TERM, 1989.

MICHAEL J. CONNOLLY,
MASSACHUSETTS SECRETARY OF STATE,
AND
BARRY C. GUTHARY, DIRECTOR,
MASSACHUSETTS SECURITIES DIVISION,
PETITIONERS,

v.

SECURITIES INDUSTRY ASSOCIATION, ET AL.,
RESPONDENTS.

Petition for a Writ of Certiorari to the United States Court of Appeals for the First Circuit.

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QUESTION PRESENTED

Does the Federal Arbitration Act, 9 U.S.C. § 1 et seq., preempt a State from protecting investors by (1) requiring securities brokers to disclose the legal effects of mandatory, pre-dispute arbitration agreements, and (2) prohibiting brokers from requiring an arbitration agreement as a non-negotiable condition of opening a brokerage account?

PARTIES TO THE PROCEEDING

The petitioners are identified in the caption. In addition to the respondent listed in the caption, the following are respondents:

Dean Witter Reynolds, Inc.;
Donaldson, Lufkin & Jenrette Securities Corp.;
Drexel Burnham Lambert, Inc.;
Fidelity Brokerage Services, Inc.;
Kidder Peabody & Co.;
Merrill, Lynch, Pierce, Fenner & Smith, Inc.;
Paine Webber Inc.;
Prudential-Bache Securities, Inc.;
Shearson Lehman Hutton, Inc.;
Smith Barney, Harris Upham & Co.

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IN THE SUPREME COURT OF THE UNITED STATES

October Term, 1989

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v.

SECURITIES INDUSTRY ASSOCIATION, et al.,

Respondents.

PETITION FOR A WRIT OF CERTIORARI
TO THE UNITED STATES COURT OF APPEALS
FOR THE FIRST CIRCUIT

Michael J. Connolly, Massachusetts Secretary of State, and Barry C. Guthary, Director, Massachusetts Securities Division, respectfully petition for a writ of certiorari to review the judgment of the United States Court of Appeals for the First Circuit in this case.

OPINIONS BELOW

The opinion of the court of appeals (App. 1a-52a) is reported at 883 F.2d 1114 (1st Cir. 1989). The opinion of the district court (App. 55a-130a) is reported at 703 F. Supp. 146 (D. Mass. 1988).

JURISDICTION

The judgment of the court of appeals was entered August 31, 1989. App. 53a. The court of appeals held that certain Massachusetts regulations were invalid as repugnant to the Federal Arbitration Act, 9 U.S.C. § 1 et seq. Petitioners invoke the jurisdiction of this Court under 28 U.S.C. § 1254(1).

CONSTITUTIONAL AND STATUTORY PROVISIONS INVOLVED

Art. VI, cl. 2, of the United States Constitution provides:

> This Constitution, and the Laws of the United States which shall be made in Pursuance thereof . . . shall be the supreme Law of the Land[.]

The Massachusetts regulations at issue are Title 950 Code of Massachusetts Regulations (CMR) 12.204(a)(2)(G) 1.a-c. The text of the regulations appears in the addendum to the opinion of the court of appeals, App. 49a-52a, and in the text of the opinion of the district court. App. 62a-63a n.5.

Section 28 of the Securities and Exchange Act of 1934, 15 U.S.C. § 78bb(a)(1982 ed.), provides in pertinent part:

> Nothing in this chapter shall affect the jurisdiction of the securities commission (or any agency or officer performing like functions) of any State over any security or any person insofar as it does not conflict with the provisions of this chapter or the rules and regulations thereunder.

Section 2 of the Federal Arbitration Act, 9 U.S.C. § 2 (1982 ed.)(the Act), provides in pertinent part:

> A written provision in any . . . contract evidencing a transaction involving commerce to settle by arbitration a controversy thereafter arising out of such contract or transaction . . . shall be valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract.

Section 3 of the Act, 9 U.S.C. § 3 (1982 ed.), provides:

> If any suit or proceeding be brought in any of the courts of the United States upon any issue referable to arbitration under an agreement in writing for such arbitration, the court in which such suit is pending, upon being satisfied that the issue involved in such suit or proceeding is referable to arbitration under such an agreement, shall on application of one of the parties stay the trial of the action until such arbitration has been had in accordance with the terms of the agreement[.]

Section 4 of the Act, 9 U.S.C. § 4 (1982 ed.), provides:

> A party aggrieved by the alleged failure, neglect, or refusal of another to arbitrate under a written agreement for arbitration may petition any United States District Court which, save for such agreement, would have jurisdiction . . . of the subject matter of a suit arising out of the controversy between the parties, for an order directing that such arbitration proceed in the manner provided for in such agreement.
>
> * * *
>
> The court shall hear the parties, and upon being satisfied that the making of the agreement for arbitration or the failure to comply therewith is not in issue, the court shall make an order directing the parties to proceed to arbitration in accordance with the terms of the agreement.
>
> * * *
>
> If the making of the arbitration agreement or the failure, neglect, or refusal to perform the same be in issue, the court shall proceed summarily to the trial thereof.

STATEMENT OF FACTS

In September, 1988, the Massachusetts Secretary of State issued regulations (1) requiring securities brokers to disclose to customers the legal effects of a mandatory "pre-dispute" arbitration clause in a brokerage agreement, and (2) prohibiting brokers from requiring such an arbitration clause as a non-negotiable condition of opening a brokerage account.

The Secretary promulgated the regulations pursuant to his authority under federal and state securities laws to regulate the conduct of securities brokers. See 15 U.S.C. § 78bb(a)(1982 ed.); Mass. Gen. Laws c. 9, § 1; c. 110A, § 412. Massachusetts has

broadly regulated the sale of securities since 1921. See Mass. St. 1921, c. 499. Massachusetts' regulation of securities brokers - like that of all other state "blue-sky" authorities - protects investors from unfair and dishonest broker conduct. See Mass. Gen. Laws c. 110A, § 101 et seq. (Uniform Securities Act).

The stated purpose of the regulations is to "provide the customer with a meaningful choice prior to making a decision to sign the [arbitration] agreement." Mass. Register No. 593 (October 14, 1988). As the district court found, the prevailing practice in the brokerage industry is not to advise prospective customers of the legal effects of the arbitration clause, and

is to require retail customers to agree to arbitrate disputes as a condition to opening a brokerage account. App. 66a-69a.[1/]

The Massachusetts regulations address these practices by requiring disclosure and bargaining in the formation of arbitration agreements.

1/ A 1987 study by the Securities and Exchange Commission (SEC), credited by the district court, confirms the growing trend by brokers to require arbitration for all securities accounts in the wake of Shearson/American Express v. McMahon, 482 U.S. 220 (1987). The study "found that arbitration agreements were all but universal for margin accounts (89 percent of the firms used such agreements) and for option accounts (83 percent of the firms used such agreements)," that 40 percent of the firms use arbitration agreements in cash accounts, and that 30 percent of the firms surveyed "had under active consideration plans to expand the number of accounts for which an arbitration agreement would be required." App. 69A n. 7.

The regulations do not prohibit brokers from entering into pre-dispute arbitration agreements with customers. A broker may enter an arbitration clause if he discloses its legal effect and does not insist on the clause without offering anything in return.[2/] A broker may, for example, negotiate a commission discount for customers who agree to arbitrate future disputes, or charge a higher commission to those who do not agree to the clause. See App. 116a. Nor do the regulations deem unenforce-

able those arbitration agreements which are entered into without compliance

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2/ Under the rules of the self-regulatory organizations, brokers are required to arbitrate upon the request of the customer, even in the absence of a predispute arbitration agreement. See Appendix to Brief of Appellant, First Circuit Docket No. 89-1022 at 469.

with the regulations. Rather, the regulations make the prohibited practices subject to sanction in broker disciplinary proceedings. See Mass. Gen. Laws c. 110A, § 204.

STATEMENT OF PRIOR PROCEEDINGS

On September 22, 1988, the Securities Industry Association and nine brokerage firms (the "industry") filed their complaint in the United States District Court for the District of Massachusetts. App. 56a. On abbreviated cross-motions for summary judgment, the district court declared the regulations preempted by the Act. App. 57a-58a, 99a-106a, 131a-132a. The

court of appeals affirmed. Although conceding that "[t]he Commonwealth may well be correct that [arbitration clauses] ought to be arrived at with greater negotiation and disclosure between broker-dealers and customers than currently takes place," App. 46a, the court ruled that "[e]ven if regulators find industry-wide practices that would be grounds for voiding arbitration agreements at common law, e.g., fraud or coercion, any separate regulatory action [such as the Massachusetts disclosure requirement] or sanction singling out arbitration agreements from contracts generally would be preempted" by the Federal Arbitration Act. App. 24a-25a (emphasis original). As petitioners

demonstrate in Part III, infra, this reasoning seriously misconstrues the purposes and objectives of the Act.

REASONS FOR GRANTING THE WRIT

I. THE DECISION BELOW PRESENTS AN IMPORTANT QUESTION CONCERNING THE AUTHORITY OF THE STATES TO PROTECT INVESTORS IN THE FORMATION OF ARBITRATION AGREEMENTS.

This case presents a question of national significance for the regulation of securities brokers by the States. Review by this Court is necessary to determine the extent of state authority to protect investors in the formation of arbitration agreements.

The growing use of mandatory arbitration agreements in the securities

and commodities industries in the wake of Shearson v. McMahon, 482 U.S. 220 (1987), has drawn increasing attention from federal and state regulators and legislators. The intense interest of state regulators is shown by the actions of the North American Securities Administrators Association (NASAA). In December, 1987, NASAA urged Congress to require brokers to negotiate arbitration agreements and to provide potential customers with a separate document explaining the terms and implications of mandatory arbitration clauses. See Statement of James C. Myer Before the Subcomm. on Telecommunications and Finance of the House Comm. on Energy and Commerce, December 16, 1987. NASAA supported its Congressional testimony

with its "Investor Hotline Study," a report which found that many of the investors who complained to NASAA after the October, 1987, market "crash," did not know that they had signed an arbitration clause and did not understand its implications. See App. 59a-60a n.2.[3/]

In October, 1988, NASAA adopted a "Resolution Concerning the Execution of Compulsory Pre-Dispute Arbitration

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3/ NASAA submitted further testimony to Congress in 1988 in support of the proposed "Securities Arbitration Reform Act of 1988," H.R. 4960, 100th Cong., 2d Sess. (June 30, 1988), which would have required disclosure and prohibited brokers from making pre-dispute arbitration clauses a condition of doing business. See 134 Cong. Rec. E 2233 (remarks of Cong. Boucher); E 2239-41 (remarks of Cong. Dingell); E 2245-46 (remarks of Cong. Markey)(daily ed. June 30, 1988) 2 Cong. Index (CCH) at 35,106 (100th Cong.); App. 61a n. 4.

Agreements as a Condition Precedent to Obtaining Brokerage Services," in which NASAA expressed "support [for] the goals and policies of the Massachusetts rules as being consistent with NASAA's purpose of advancing the principle of investor protection and affording choice to investors in their decisions to participate in the securities markets." App. 59a-60a n.2. NASAA also filed a brief amicus curiae in the court of appeals in this case which stated that "at least 15 other members [of NASAA] would consider adopting some form of regulation covering mandatory arbitration clauses and disclosure of investor rights." Brief at 4.[4/]

4/ NASAA also is expected to file a brief amicus curiae in this Court supporting this petition.

The national importance of this issue is similarly shown by the actions of federal agencies which have addressed mandatory arbitration clauses. The Commodities Futures Trading Commission (CFTC), for example, has enforced regulations similar to the Massachusetts regulations since 1976. Title 17 C.F.R. 180.3(b) precludes a commodities broker from entering into a mandatory predispute arbitration agreement with a customer unless, inter alia, the agreement is not a condition for the customer to utilize the services of the broker, and the agreement contains cautionary language in large bold-face type, separately endorsed by the customer, that enumerates the customer's rights and the legal effect of the agreement. The

existence of § 180.3(b) prompted the CFTC to file a letter in the court of appeals in this case which stated that "Commission regulation 180.3 does not conflict with the Federal Arbitration Act because both provisions reflect a policy favoring the arbitration of commodities disputes, and because regulation 180.3 enhances, not diminishes, the likelihood that pre-dispute arbitration agreements that comply with its terms will be enforced."[5/]

5/ In promulgating its original regulations in 1976, the CFTC considered arguments that the cautionary language "would be in the nature of a warning against use of an arbitration procedure and would thus discourage persons from signing pre-dispute arbitration agreements[,]" and that "[s]uch warnings are not usual in commercial contracts,' and 'can only result in frightening away some customers.'" 41 Fed. Reg. 42,943

(footnote continued)

The Securities and Exchange Commission (SEC) has also recently (but partially) addressed voluntariness in the entry of arbitration agreements. On May 10, 1989, the SEC issued an "Order Approving Proposed Rules Changes by the New York Stock Exchange, Inc., National Association of Securities Dealers, Inc., and the American Stock Exchange, Inc., Relating to the Arbitration Process and the Use of Predispute Arbitration

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(footnote continued)

(Sept. 29, 1976). In response, the CFTC reiterated "its positive attitude toward the settlement of disputes by arbitration. It does not follow from this, however, that the Commission can or should leave a customer unaware of the purpose of the agreement he is requested to sign." Id. The CFTC noted that it believed that "cautionary language is necessary to assure an informed consent on the part of the customer at the time he enters into the arbitration agreement." Id.; see 41 Fed. Reg. at 42,945.

clauses." 54 Fed Reg. 21,144 (May 16, 1989). See App. 32a-33a. As the court of appeals noted below, the SEC approved exchange rules "requiring brokers to discuss customers' rights under mandatory arbitration agreements and to include language in arbitration clauses informing customers that they are waiving judicial fora." Id. at 32a-33a. The SEC declined, however, to adopt rules that would prohibit brokers from requiring arbitration clauses as a condition of opening an account, on the hope that "competitive forces" in the market would provide more choice. 54 Fed. Reg. at 21,154.[6/]

6/ That brokerage firms uniformly require arbitration agreements and do not offer arbitration-less accounts even at higher prices suggests a classic market failure. Investors do not shop

(footnote continued)

The court of appeals dismissed the CFTC and SEC actions as irrelevant because they are "products of federal, not state, authority." App. 33a. But the actions of these federal regulators strongly support certiorari in this case because they demonstrate that there is national interest in the issues

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(footnote continued)

for brokerage firms on the basis of arbitration clauses because they do not focus on the eventuality of a dispute arising with their broker. See Rakoff, Contracts of Adhesion: An Essay in Reconstruction, 96 Harv. L. Rev. 1174, 1226-1227 (1983). And brokerage firms do not compete on arbitration clauses precisely because they do not want customers to focus on such an eventuality, for fear of souring their customer relationships. See, e.g., Affidavit of Theodore Kresbach, ¶ 6, 1st. Cir. App. 688-89. In this way, agreements without arbitration clauses are similar to consumer product safety features or warranties which are offered at inefficient levels in the absence of regulation. See, e.g., Posner, Strict Liability: A Comment, 2 J. Leg. Stud. 205, 211 (1973).

presented and important public interests protected by the Massachusetts regulations. Further, the belated and limited SEC action shows that there is a pressing need for a decision by this Court defining the extent of state authority to supplement federal regulation of the disclosure and negotiability of arbitration agreements.

In sum, the Massachusetts regulations address a new problem in an established area of state concern - the conduct of securities brokers. In taking limited steps to assure voluntariness in arbitration agreements, Massachusetts has served as a "laboratory" for the development of new protections for investors. See New State Ice Co. v. Liebmann, 285 U.S. 262,

311 (1932)(Brandeis, J., dissenting). The court of appeals struck down these protections as repugnant to the Federal Arbitration Act. Plenary review is necessary in order to rectify the error below and define the extent of state power in this important area.

II. THE DECISION HAS NATIONAL IMPLICATIONS FOR STATE REGULATION OF MANDATORY ARBITRATION AGREEMENTS IN BANKING, HEALTH CARE, AUTOMOBILE, AND MANY OTHER INDUSTRIES.

Review by this Court is also necessary in order to define the scope of state power to regulate, in any fashion, the formation of arbitration

clauses in consumer agreements in banking, health care, car sales, and other areas of historic state concern. Under the preemption theory applied by the court of appeals, a state is powerless to require disclosure in connection with arbitration clauses in consumer contracts unless the State requires the same disclosure in all contracts, whether or not involving consumers. Prompt and plenary review by this Court will define the authority of the States to apply traditional consumer protection regulation to arbitration agreements and avoid harm to consumers and the States that will flow from inconsistent decisions in the lower courts.

Mandatory arbitration clauses in the banking industry are becoming commonplace. See J. Butler, Arbitration in Banking - State of the Art (Robert Morris Associates, 1988); California Banks are Using Arbitration to Cut Court Costs, Avoid Jury Verdicts, 2 ADR Rep. (BNA) 181-82 (May 12, 1988). Bank of America, for example, currently includes mandatory arbitration clauses in commercial loans and consumer safety deposit agreements. J. Butler, supra, at 24. Similarly, Marathon National Bank, a commercial bank based in Los Angeles, "has decided to initiate arbitration for virtually all its disputes with customers, vendors, employees, and others." Id. at 26-27.

The use of mandatory arbitration clauses has also spread to agreements between patients and their doctors and health insurers. Under common agreements between doctors and patients, patients agree to mandatory arbitration of future claims of medical malpractice. See generally Note, Medical Malpractice Arbitration: A Patient's Perspective, 61 Wash. Univ. L. Rev. 123 and App. A and C (1983); see also Sanchez v. Sirmons, 121 Misc.2d 249, 467 N.Y.S.2d 757 (1983) (arbitration clause in "consent to abortion" form).

Health insurers have similarly included mandatory arbitration clauses in group health benefit contracts. See, e.g., Madden v. Kaiser Foundation

Hospitals, 17 Cal.3d 699, 131 Cal. Rptr. 882, 552 P.2d 1178 (1976)(contract between Kaiser Foundation Health Plan, Inc., and the State of California, governing group medical plan for state employees). Mandatory arbitration clauses thus cover thousands of private and state and federal employees. See id., 552 P.2d at 1180; Dinong v. Superior Court, 102 Cal. App.3d 845, 162 Cal. Rptr. 606 (1980)(contract between Kaiser Foundation Health Plan, Inc., and the United States Civil Service Commission); see also 5 U.S.C. § 8902 (1988 ed.)(Office of Personnel Management authorized to contract for group health benefit plans for federal employees).

While many States endorse the arbitration of medical service claims, many of the same States require disclosure and bargaining of agreements to arbitrate such claims. For example, California specifies the precise language that must be used in arbitration clauses in all "contracts for medical services," and requires notice, in "10 point bold red type," that the arbitration agreement waives the "right to a jury or court trial." Cal. Civ. Proc. Code § 1295(a) and (b)(West 1982 ed.). Other States require similar disclosures. See Ohio Rev. Code Ann. § 2711.23 (Banks-Baldwin 1989 Supp.)(requiring, inter alia, a separate document for the arbitration agreement); South Dakota Cod. Laws Tit. 21-25B-3

(Michie 1987 ed.) Michigan requires that the agreement "shall be accompanied by an information brochure. . . ." Mich. Comp. Laws § 600.5041 (West 1987 ed.)

In addition to requiring disclosure of the waiver of a patient's right to a trial, Illinois requires language, in specified form and size, informing persons that they "cannot be required to sign [the arbitration] agreement in order to receive treatment." Ill. Rev. Stat. c. 10, § 209 (West 1987 ed.). Alaska and Michigan have similar requirements. See Alaska Stat. § 0.9.55.535(b) (Michie 1988 ed.) (requiring "in bold print on face of agreement" statement that "execution of the agreement is not a prerequisite to

receiving treatment or care; form used "shall be approved in advance by the attorney general of the state to assure that it fairly informs both parties to the agreement and properly protects their interests"); Mich. Comp. Laws § 600.5041(2) and (5)(West 1987 ed.); see also South Dakota Atty. Gen. Op. No. 76-98 (health maintenance organization's enrollee contracts cannot make arbitration agreement a prerequisite to medical care or treatment).

Yet another industry affected by the issue presented in this case is the automobile industry. In Saturn Distribution Corp. v. Williams, Commissioner of the Department of Motor Vehicles of Virginia, 717 F. Supp. 1147 (E.D. Va. 1989), the district court held that

the Federal Arbitration Act does not preempt a Virginia statute which prohibits automobile manufacturers from requiring franchise dealers to sign arbitration clauses as a condition of dealership agreements. The district court expressly rejected the reasoning of the courts below in this case. The Fourth Circuit will hear oral argument on the manufacturers' appeal in Saturn on December 6, 1989. (Docket No. 89-2773). Whatever the outcome of that appeal, the Saturn case shows that the implications of the decision below in this case extend far beyond the securities industry.

The issue presented by these state statutes governing disclosure and bargaining is not whether arbitration

agreements in consumer contracts may be enforced, (see Southland Corp. v. Keating, 465 U.S. (1984)), but whether the States have any authority to ensure that arbitration agreements are entered into knowingly and voluntarily, in lieu of case by case adjudications under traditional contract law doctrines. This issue is squarely presented by this petition and warrants plenary review at this time.

III. THE DECISION BELOW MISCONSTRUED THE PURPOSES AND OBJECTIVES OF THE FAA.

The "FAA contains no express pre-emptive provision, nor does it reflect a congressional intent to occupy

the entire field of arbitration." Volt Information Sciences, Inc. v. Board of Trustees of Leland Stanford Junior University, 109 S.Ct. 1248, 1254 (1989). Whether a state law is preempted by the FAA thus depends on whether it "stands as an obstacle to the accomplishment and execution of the full proposes and objectives of Congress." Id. at 1255 (quoting Hines v. Davidowitz, 312 U.S. 52, 67 (1941)). The decision below purported to apply this preemption test, but the court misconstrued the purposes and objectives of the FAA.[7/]

7/ The court below also appears to have placed on Massachusetts the burden of proving that Congress did not intend to preempt the state regulations. See App. 19a (noting duty of courts to "defend [the Act's] mechanisms vigilantly and with some fervor," and to "be on guard

(footnote continued)

"Congress' principal purpose" in enacting the FAA, which the court below ignored, was to "ensur[e] that private arbitration agreements are enforced according to their terms." Volt, 109 S.Ct. at 1255. Thus, this Court has held that state "anti-waiver" laws, which "require a judicial forum for the resolution of claims which the contracting parties agreed to resolve by

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(footnote continued)

for artifices in which the ancient suspicion of arbitration might reappear"); App. 31a (noting that the state had failed to carry its burden "to show that Congress intended to preclude a waiver of judicial remedies"). This was error since "federal law pre-empts state law in traditional fields of state regulation only when 'that was the clear and manifest purpose of Congress.'" E.g., Coit Independence Joint Venture v. Federal Savings and Loan Ins. Corp., 109 S.Ct. 1361, 1377 (1989) (Scalia, J., concurring) (quoting Rice v. Sante Fe Elevator Corp., 331 U.S. 218, 230 (1947)).

arbitration," are preempted by the Act. Southland Corp. v. Keating, 465 U.S. 1, 10 (1984) (state law that made agreements to arbitrate certain franchise claims unenforceable held preempted because it "directly conflicts" with section 2 of the Act); Perry v. Thomas, 482 U.S. 483, 491 (1987) (similar state law barring enforcement of agreement to arbitrate wage-collection claims held preempted because it was in "unmistakeable conflict" with federal policy). However, this Court has never suggested that state laws, such as the Massachusetts regulations, that simply require disclosure and bargaining in the formation of arbitration agreements in a regulated industry are preempted.

Such disclosure and bargaining requirements do not conflict with the Act's primary purpose of "enforcing arbitration agreements according to their terms," because they do not limit the ability of parties to enter into arbitration agreements, nor limit the enforcement of arbitration agreements once entered. On the contrary, by serving as a prophylactic against "claims that the agreement to arbitrate resulted from ... fraud or overwhelming economic power," Mitsubishi Motors v. Soler Chrysler-Plymouth, Inc., 473 U.S. 614, 627 (1985), such state laws advance the primary propose of the Act by making it more likely that arbitration agreements that conform to the laws will be enforced. See Brief Amicus Curiae of

the CFTC in the First Circuit ("Commission regulation 180.3 does not conflict with the FAA because both provisions reflect a policy favoring the arbitration of commodities disputes, and because regulation 180.3 enhances, not diminishes, the likelihood that predispute arbitration agreements that comply with its terms will be enforced."); see also Smokey Greenhaw Cotton v. Merrill Lynch Pierce Fenner & Smith, Inc., 720 F.2d 1446, 1450 (5th Cir. 1983) (broker's compliance with CFTC Rule 180.3 militates against claim of fraud).

The court below nonetheless held the Massachusetts regulations preempted because it found that the regulations conflicted with the Act's "liberal federal policy favoring arbitration

agreements." App. 18a-39a (quoting Moses H. Cone Memorial Hospital v. Mercury Constr. Corp., 460 U.S. 1, 24 (1983)). The court viewed the regulations as a "gyve" or "shackle" that would "inhibit a party's willingness to create an arbitration agreement" or would "frustrate" arbitration. App. 27a. But this view is contrary to the views of both the CFTC and the SEC. See Amendments to CFTC Rules Governing Arbitration or Other Dispute Settlement Procedures, 41 Fed. Reg. 42,943 (Sept. 29, 1976) (CFTC has "positive attitude toward the settlement of disputes by arbitration. It does not follow from this, however, that the Commission can or should leave a customer unaware of

the purpose of the agreement he is requested to sign."); Order Approving Proposed Rule Changes by the New York Stock Exchange, Inc., et al., 54 Fed. Reg. 21,144, 21,154 (May 16, 1989) (hereinafter cited as SEC Order) (disclosures alerting investors to the meaning of arbitration contracts they are signing "should promote more knowledgable acquiesence or rejection by customers of arbitration provisions"). Moreover, the record is devoid of any basis on which the court below could reasonably predict the likely effect of the regulations on arbitration agreements, since the regulations permit brokers to induce investors to enter

into arbitration agreements, e.g., by offering a reduced commission.[8/]

In any event, the court below misconstrued the "liberal federal policy favoring arbitration" to suggest that arbitration per se is a goal of the FAA. E.g., App. 3a ("The hope has long been that the Act could serve as a therapy for the ailment of the crowded docket.") This approach conflicts with the recent ruling of this Court that "[w]hile Congress was no doubt aware

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8/ In opposing summary judgment in the district court, Massachusetts moved for relief under Fed. R. Civ. P. 56(f). App. 99a-106a, 48a n.10. As grounds for its motion Massachusetts cited its pending discovery, which sought additional facts concerning the alleged effects of the regulations on the entry of arbitration agreements by brokers and customers. The district court denied the motion, and the court of appeals essentially affirmed. App. 106a, 48a n.10.

that the Act would encourage the expeditious resolution of disputes, its passage 'was motivated, first and foremost, by a congressional desire to enforce agreements into which parties had entered.'" Volt, 109 S.Ct. at 1254 (quoting Dean Witter Reynolds, Inc. v. Byrd, 470 U.S. 213, 220 (1985)). Thus, in Volt this Court upheld the application of a state arbitration rule, which had been incorporated into an arbitration agreement via a choice-of-law provision, "even if the result is that arbitration is stayed where the Act would otherwise permit it to go forward." Volt, 109 S.Ct. at 1255. Moreover, this Court has "recognized that the FAA does not require parties to arbitrate when they have not agreed

to do so." Id. At bottom, therefore, the liberal federal policy favoring arbitration is not, as the court below suggested, a policy designed to promote a particular kind of conduct, but rather a policy to "give effect to the contractual rights and expectations of the parties. . . ." Volt, 109 S.Ct. at 1256; see H.R. Rep. 96, 68th Cong., 1st Sess. 1 (1924) ("effect of the bill is simply to make the contracting party live up to his agreement").

To the extent the Act was designed, in part, to promote arbitration, it was plainly intended to facilitate consensual arbitration. See Volt, 109 S.Ct. at 1256 ("Arbitration under the Act is a matter of consent, not

coercion"); S. Rep. No. 536, 68th Cong., 1st Sess. 1, 3 (1924) ("The record ... shows not only the great value of voluntary arbitrations but the practical justice in the enforced arbitration of disputes where written agreements for that purpose have been voluntarily and solemnly entered into.")(emphasis added); see also Prima Paint Corp. v. Flood & Conklin Mfg. Co., 388 U.S. 395, 414 (1967) (legislative history demonstrates that Act was not intended to cover arbitration clauses offered to captive customers or employees or a take-it-or-leave-it bases) (Black, J. dissenting) (citing Hearing on S. 4213 and S. 4214 before the Subcomittee of the Senate Committee on the Judiciary, 67th Cong., 4th Sess. 9-11 (1923));

Shearson/American Express Co. v. McMahon, 482 U.S. 220, 226, 230 (1987) (voluntariness of agreement irrelevant to whether Exchange Act of 1934 bars waiver of judicial remedies but well-founded claim of fraud or excessive economic power would provide basis for voiding agreement under ordinary principles of contract law).

The Massachusetts regulations were designed to "provide the customer with a meaningful choice prior to making a decision to sign the agreement," Mass. Reg. No. 593 (October 14, 1988), in market circumstances in which the customer's choice has been sharply restricted.[9/] Thus, the Massachusetts

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9/ See SEC Order, 54 Fed. Reg. at 21,153 n. 51 (SEC study found that nearly all brokerage firms required

(footnote continued)

regulations are faithful to the federal policy favoring consensual arbitration.

The court below also found the regulations preempted because they "take their meaning precisely from the fact that a contract to arbitrate is at issue," App. 40a (quoting Perry v. Thomas, 482 U.S. at 492 n.9), and thus allegedly conflict with the Act's "principle of rigorous equality." App. 20a. The court rejected as "casuistry"

(footnote continued)

retail customers to sign a pre-dispute arbitration agreement to open a margin or option account; 39% of firms required such agreements for cash accounts); see also Ames v. Merrill Lynch, Pierce, Fenner & Smith, 567 F.2d 1174, 1178 (2d Cir. 1977) ("It ... became apparent [to the CFTC] that in many cases arbitration was not undertaken voluntarily by customers, but that customers were compelled to agree to predispute arbitration clauses as a precondition to doing business.")

the Commonwealth's argument below that, because the regulations apply conditions to the formation of securities arbitration agreements that are common to, if not the rule of, Massachusetts consumer contracts generally and securities transactions in particular, the regulations were consistent with the Act's "equal footing" objective. See Dean Witter Reynolds, Inc. v. Byrd, 470 U.S. at 219 (Act was designed in part "to place [arbitration] agreements 'upon the same footing as other contracts,'") (quoting H.R. Rep. No. 96, 68th Cong., 1st Sess. 1, 2 (1924)).[10/] The court held: "Even if regulators find industry-wide practices that would be grounds to

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10/ This was the view of the district court in Saturn Distribution Corp. v. Williams, 717 F. Supp. at 1152-1153.

voiding arbitration agreements at common law, e.g., fraud or coercion, any separate regulatory action or sanction singling out arbitration agreements from contracts generally would be preempted." App. 24a-25a (emphasis in original). Thus, according to the court below, a state securities regulator may only require disclosure or bargaining in the formation of arbitration agreements in the securities industry if the state requires such disclosure or bargaining in the formation of all contracts and contract terms, and if the state does so by means of a regulatory sanction.

This application of the Act's "equal footing" objective is irrational and does violence to the objectives of the

FAA. Massachusetts does not require disclosure and bargaining in all contracts, because market circumstances do not universally demand such regulation, particularly as between commercial enterprises. However, given the circumstances in which securities brokers generally employ arbitration agreements (i.e., in a highly regulated industry, with disparity in bargaining power between brokers and retail investors, the absence of competition among brokers on arbitration terms, investors' lack of meaningful choice, and investors' right under the exchange rules to demand arbitration even in the absence of an arbitration agreement), exempting securities arbitration agreements from minimal consumer

protection regulation -- "Congress barred the states from making determinations about arbitration contracts that states remained free to make about, say, used car sales," App. 24a -- places arbitration agreements on a footing well above other contracts, contrary to the intent of Congress. See Prima Paint v. Flood & Conklin Manufacturing Co., 388 U.S. 395, 404 n.12 (1967) (Act was designed "to make arbitration agreements as enforceable as other contracts, but not more so"). Plenary review is necessary to rectify the court's misreading of congressional intent and to prevent further harm to legitimate state regulation.

CONCLUSION

For the reasons set forth above, the petition for a writ of certiorari should be granted.

Respectfully submitted,

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Dated: November 29, 1989

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APPENDIX A

UNITED STATES COURT OF APPEALS
FOR THE FIRST CIRCUIT

No. 89-1022

SECURITIES INDUSTRY ASSOCIATION, et al.,

Plaintiffs, Appellees,

v.

MICHAEL J. CONNOLLY, ETC., et al.,

Defendants, Appellants.

APPEAL FORM THE UNITED STATES
DISTRICT COURT FOR THE
DISTRICT OF OF MASSACHUSETTS

[Hon. Douglas P. Woodlock,
U.S. District Judge]

Before

Campbell, Chief Judge,
Selya, Circuit Judge,
and Caffrey,* Senior District Judge.

August 31, 1989

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*of the district of Massachusetts,
sitting by designation.

SELYA, Circuit Judge. Hypertrophy is the pathologic "overgrowth . . . of an organ or part . . . resulting from unusually steady or severe use . . . ." Webster's Third New International Dictionary 1114 (1981). Metaphorists seem to find the condition irresistible. Thus, hypertrophy has been used as a partial explanation for the collapse of entire intellectual systems, e.g., Kuhn, The Structure of Scientific Revolutions (2d ed. 1970), and detailed mechanical intellectual artifacts, e.g., Posner, Goodbye to the Bluebook, 54 U. Chi. L. Rev. 1343 (1986). We succumb today to the same temptation, for we find the metaphor especially apt in discussing the rampant growth of the civil docket in the United States.

We need not belabor the point. Increased resort to the courts, and the consequent tumefaction of already-swollen court calendars, have received considerable attention, see, e.g., Heydebrand & Seron, The Rising Demand for Court Services, 11 Just. Sys. J. 303 (1986); Galanter, The Day After the Litigation Explosion, 46 Md. L. Rev. 3 (1986); Lieberman, The Litigation Society (1981), so we merely note the phenomenon and do not comment further upon it. We focus instead on arbitration, a contractual device that relieves some of the organic pressure by operating as a shunt, allowing parties to resolve disputes outside of the legal system. Congress passed the Federal Arbitration Act (FAA or Act), 9 U.S.C. §§ 1-14 (1982), to help legitimate

arbitration and make it more readily useful to disputants. The hope has long been that the Act could serve as a therapy for the ailment of the crowded docket. As might be expected, there is a rub: the patient, and others in interest, often resist the treatment.

I

We are asked to decide today if certain regulations, Mass. Regs. Code tit. 950, §§ 12.204 (G)(1)(a)-(c) (Regulations), set forth in the appendix hereto, are preempted by the FAA. The Regulations are part of a set which governs the conduct of those who sell securities in the Commonwealth. The provisions at issue were promulgated at one time. Neither party suggested to

the district court that any of the provisions might be serverable, so we treat them as a unit for purposes of our preemption analysis. See Clauson v. Smith, 823 F.2d 660, 666 (1st Cir. 1987) (court of appeals will ordinarily eschew consideration of theories not raised below).

The contracts to which the Regulations apply implicate interstate and international commerce, as well as the instrumentalities of that commerce, thus subjecting them to the reach of the FAA. See 9 U.S.C. § 1; see generally Societe Generale de Surveillance, S.A. v. Ratheon European Management and Systems Co., 643 F.2d 863, 867 (1st Cir. 1981) (the term "commerce" as used in the Act is to be broadly construed). Specifically, the Regulations are aimed

at broker-dealers who require customers to sign pre-dispute arbitration agreements (PDAAs) as a concomitant of establishing account relationships. Not coincidentally, many of the major brokerage firms prefer to follow some such praxis. Cf. Drayer v. Krasner, 572 F.2d 348, 353-54 (2d Cir.), cert. denied, 436 U.S. 948 (1948) (discussing industry-wide use of arbitration to resolve disputes between broker-dealers and registered representatives).

The Regulations not only regulate; they do so in a manner patently inhospitable to arbitration. They (i) bar firms from requiring individuals to enter PDAAs as a nonegotiable condition precedent to account relationships, § 12.204(G)(1)(a); (ii) order the prohibition brought "conspicuously" to the attention of prospective customers,

§ 12.204(G)(1)(b); and (iii) demand full written disclosure of "the legal effect of the pre-dispute arbitration contract or clause," § 12.204(G)(1)(c).

In Massachusetts, regulation of securities falls within the province of the Secretary of State, who superintends the Securities Division. Immediately upon adoption of the Regulations in September 1988, the Securities Industry Association and ten brokerage firms affiliated with it[1/] sued in federal

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1/ The ten houses comprise Dean Witter Reynolds, Inc., Donaldson, Lufkin & Jenrette Securities Corp., Drexel Burnham Lambert, Inc., Fidelity Brokerage Services, Inc., Kidder Peabody & Co., Merrill Lynch, Pierce, Fenner & Smith, Inc., Painewebber Inc., Prudential-Bache Securities Inc., Shearson Lehman Hutton, Inc., and Smith Barney, Harris Upham & Co. We refer to them and the trade association plaintiff, collectively, as "SIA" or "appellees."

district court seeking a declaration that the Regulations were unconstitutional because they conflicted with the provisions and policies of the FAA. SIA also sought a preliminary injunction barring enforcement of the Regulations. The suit named the Secretary of State and the director of the Securities Division (appellants before us) as defendants. Claiming that the Commonwealth had power to issue the Regulations as part of its concurrent authority to regulate securities transactions, see Mass. Gen. L. ch. 110A, §§ 201, 204 (1984) (governing registration of broker-dealers), appellants stood their ground. Cross-motions for summary judgment were

eventually filed. In due course, in district court granted declaratory and injunctive relief in appellees' favor. Securities Indus. Ass'n v. Connolly, 703 F. Supp. 146 (D. Mass. 1988). This appeal followed.

III.

A

The Supremacy Clause of Article VI of the federal Constitution prevents the states from impinging overmuch on federal law and policy. See Louisiana Pub. Serv. Comm'n v. FCC, 476 U.S. 355, 368 (1986). Preemption - the vehicle by which the Supremacy Clause is generally enforced - always boils down to a matter

of congressional intent. Schneidewind v. ANR Pipeline Co., 108 S.Ct. 1145, 1150 (1988); California Fed. Sa[illegible] Loan Ass'n v. Guerra, 479 U.S. 272, 280 (1987); Wardair Canada, Inc. v. Florida Dep't of Revenue, 477 U.S. 1, 6 (1986); French v. Pan Am Express, Inc. 869 F.2d 1, 2 (1st Cir. 1989); Wood v. General Motors Corp., 865 F.2d 395, 401 (1st Cir. 1988). And, because Congress has not expressly delineated the preemptive reach of the FAA, our task is to determine the extent of any implied preemption vis-a-vis the state's Regulations.

We have acknowledged before that "[t]he concept of implied preemption has a certain protean quality," a circumstance which tends to defeat courts' efforts to establish tidy

creedal subcategories. French, 869 F. 2d at 2. Yet, although we continue to "abjure taxonomy for taxonomy's sake," id., it is sometimes helpful to sketch the borders of the doctrine by reference to commonly used descriptions. Thus, it has been said that implied preemption prospers when Congress intends its enactments "to occupy a given field to the exclusion of state law." Schneidewind, 108 S.Ct. at 1150. That is not the case here: Congress did not want the FAA to occupy the entire field of arbitration law. Volt Information Sciences, Inc. v. Board of Trustees of Leland Stanford Junior Univ., 109 S.Ct. 1248, 1254 (1989); New England Energy Inc. v. Keystone Shipping Co., 855 F.2d 1, 4 (1st Cir. 1988), cert. denied, 109 S. Ct. 1527 (1989). State law may also

be preempted "when it actually conflicts with federal law." Schneidewind, 108 S. Ct. at 1150; see also Perry v. Thomas, 482 U.S. 483, 491 (1987). In this respect, substance takes precedence over form; a direct, facial contradiction between state and federal law is not necessary to catalyze an "actual conflict" within the doctrinal parameters of the Supremacy Clause.

Whatever labels may be affixed, the pivot upon which our inquiry turns remains constant: where Congess has failed explicitly to detail the dimensions of displacement, courts must decide if "the state law disturbs too much the congressionally declared scheme . . . ." Palmer v. Liggett Group, Inc., 825 F.2d 620, 626 (1st Cir. 1987); see also French, 869 F.2d at 2 (adopting a practical preemption

analysis which focuses "on the effect which the challenged enactment will have on the federal plan"). Put another way, a state law or regulation cannot take root if it looms as an obstacle to achievement of the full purposes and ends which Congress has itself set out to accomplish. Schneidewind, 108 S.Ct. at 1151; California Coastal Comm'n v. Granite Rock Co., 107 S.Ct. 1419, 1425 (1987); Silkwood v. Kerr-McGee Corp., 464 U.S. 238, 248 (1984); Hines v. Davidowitz, 312 U.S. 52, 67 (1941).

B

Here, then, the critical inquiry is whether the FAA is an enactment which Congress meant to remain relatively unfettered; and if so, whether the Regulations intrude impermissibly. We

approach our task mindful both that interpretation of a statute's meaning must start with the text itself, United States v. James, 478 U.S. 597, 604 (1986), and that the language chosen by Congress must be accorded its ordinary meaning, American Tobacco Co. v. Patterson, 456 U.S. 63, 68 (1982). In this instance, the relevant statutory phraseology is not technical, embodies conventional terms, and has a virtue of brevity:

> A written provision in any maritime transaction or a contract evidencing a transaction involving commerce to settle by arbitration a controversy thereafter arising out of such contract or transaction, or the refusal to perform the whole or any part thereof, or an agreement in writing to submit to arbitration an existing controversy arising out of such a contract, transaction, or refusal, shall be valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract.

9 U.S.C. § 2. The language sweeps broadly and brooks little reservation. We must, therefore, be chary of a narrowing construction, lest such an interpretive modality clog the channel Congress has opened. See Volt, 109 S. Ct. at 1254-55.

Reluctance to shrink the scope of section 2 seems particularly well advised given the Supreme Court's resounding endorsement of the "ordinary language" technique in construing the FAA. See, e.g., Prima Paint Corp. v. Flood & Conklin Mfg. Co., 388 U.S. 395, 404 (1967). The Court has concluded that this approach comports with Congress's "unmistakably clear . . . purpose that the arbitration procedure, when selected by the parties to a contract, be speedy and not subject to

delay and obstruction." Id. Nor is Prima Paint in any sense aberrational; just this year, in the course of overruling Wilko v. Swan, 346 U.S. 427 (1953)(a decision voiding certain PDAAs under § 14 of the Securities Act of 1933), the Court again emphasized "the strong language" of the FAA and noted the heavy burden borne by opponents of the arbitral alternative. See Rodriguez de Quijas v. Shearson/American Express, Inc., 109 S.Ct. 1917, 1921 (1989).

C

Because the language of the Act seems clear, and its meaning plain, we are not obliged to plumb the Congress's collective consciousness to ascertain legislative intent. James, 478 U.S. at

606; Rubin v. United States, 449 U.S. 424, 430 (1981). It nevertheless seems prudent to do so, if only "[a]s a check upon our reading of the statute." Kwatcher v. Massachusetts Service Employees Pension Fund, No. 88-1930, slip op. at 9 (1st Cir. July 5, 1989).

In recent decades, the Supreme Court has faced a number of disputes involving the FAA. In case after case, the Justices have read the Act's legislative history with an avuncular eye; as the court below perspicaciously observed, "[r]ecent history has found the Supreme Court offering endorsements of the arbitration process by expansive statements of the intent of Congress in passing the Federal Arbitration Act." 703 F. Supp. at 150-51 (citing representative cases). We have lately witnessed yet another illustration of

this trend. See Rodriguez de Quijas, 109 S.Ct. at 1920 (acknowledging the Court's "current strong endorsement of the federal statues favoring [arbitration]"). Although an arbitral remedy has not invariably prevailed, see, e.g., Alexander v. Gardner-Denver Co., 415 U.S. 36, 51-52 (1974) (Title VII employment discrimination claim could be litigated in a judicial forum notwithstanding PDAA), the Court has almost always given the Act a reading which is both broad and deep.

Congress, we are told, enacted the FAA to relieve parties from what, even two-thirds of a century ago, was characterized as "'the costliness and delays of litigation.'" Dean Witter Reynolds Inc. v. Byrd, 470 U.S. 213, 220 (1985) (quoting H.R. Rep. No. 96, 68th Cong., 1st Sess. 2 (1924)). Common-law

courts had jealously guarded the sovereign's perceived prerogative to handle disputes among its constituents, preserving the courts' jurisdiction to resolve controversies once they had been solemnized. Byrd, 479 U.S. at 220 n.6. The FAA was enacted to overcome this "anachronism." Id. In harmony with that purpose, the Act declares "a liberal federal policy favoring arbitration agreements." Moses H. Cone Memorial Hospital v. Mercury Constr. Corp., 460 U.S. 1, 24 (1983); see also Rodirguez de Quijas, 109 S.Ct. at 1919; Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc., 473 U.S. 614, 625 (1985). Such a policy is desirable because it best effectuates the "congressional desire to enforce agreements into which parties had entered." Byrd, 470 U.S. at 220. At

the same time, courts must be on guard for artifices in which the ancient suspicion of arbitration might reappear. See Shearson/American Express, Inc. v. McMahon, 482 U.S. 220, 226 (1987); Byrd, 470 U.S. at 221.[2/]

In sum, the legislative history of the FAA, like its text, indicates that the courts must receive the Act hospitably and defend its mechanisms vigilantly and with some fervor.

D

The metaphors used to describe the Court's interpretations are somewhat

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2/ We think that the Court, by taking the formidable step of overruling its own precedent, has demonstrated how tightly impulses hostile to arbitration must be constrained in order to remain faithful to Congress's mandate. See Rodriguez de Quijas, 109 S.Ct. at 1920 (in part, Wilko must fall because it is "pervaded by . . . 'the old judicial hostility to arbitration'") (citation omitted).

varied, but their common denominator is a principle of rigorous equality under 9 U.S.C. § 2.[3/] Given this interpretive

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3/ Volt is not to the contrary. There, the Court ruled that "interpreting a choice-of-law clause to make applicable state rules governing the conduct of arbitration - rules which are manifestly designed to encourage resort to the arbitral process - simply does not offend the rule of liberal construction . . . nor does it offend any other policy embodied in the FAA." 109 S. Ct. at 1254 n.5. But, the choice-of-law provision in Volt did not impinge on the validity or enforceability of the arbitral contract. See id. at 1254. The California regulation filled in an interstice in the FAA, id at 1254 n. 5, whereas the Regulations here at issue plainly undermine the presumption of validity that the Act meant to confer on arbitration contracts generally. See Perry, 482 U.S. at 492 n.9 (making distinctions between choosing which law of unconscionability applies and not

(footnote continued)

model, and the statute's twofold use of the term "any" - it is, after all, "difficult to imagine broader language," James, 478 U.S. at 604 (footnote omitted) - the words of 9 U.S.C. § 2 must be ceded their full import. What seems beyond dispute at this juncture is that no state may simply subject arbitration to individuated regulation in the same manner as it might subject some other unprotected contractual device (say, a prescriptive period or exculpatory clause contained within a private contract). Thus, for example, the Eighth Circuit struck down Missouri's effort to require that

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(footnote continued)

whether law of unconscionability applies to arbitration); see also New England Energy, 855 F.2d at 4-5 (states may enact regulations to fill gaps left by the FAA).

contracts highlight the existence of arbitration clauses by use of 10-point capital letters, Webb v. R. Rowland & Co., 800 F.2d 803, 806 (8th Cir. 1986), and earlier refused to honor a state requirement that arbitration agreements bear an attorney's acknowledgement attesting that all parties had been informed of the agreement's effects, Collins Radio Co. v. Ex-Cell-O-Corp., 467 F.2d 995, 997 (8th Cir. 1972). Any similar limitary approach would seemingly defeat the very aim of the Act, allowing states to revivify the ancient jurisdictional antagonism toward arbitration by cloaking it in regulatory garb. At the very least, such enmity, however manifested in state law,[4/] is

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4/ That the restriction is administrative rather than legislative or judge-made in no way validates appellants' maneuver.

(footnote continued)

preempted. Volt, 109 S. Ct. at 1253; Perry, 482 U.S. at 492 n.9; Mitsubishi Motors, 473 U.S. at 626-27; Byrd, 470 U.S. at 219-21; Southland Corp. v. Keating, 465 U.S. 1, 18-19 (1984); Moses Cone, 460 U.S. at 24-25; Prima Paint, 388 U.S. at 404 n.12; New England Energy, 855 F.2d at 4-5.

Appellants conceded before the district court, 703 F. Supp. at 152, and on appeal, that the Regulations apply only to arbitration agreements. They

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(footnote continued)

The gravamen of the FAA is to preserve the arbitral bargain against external onslaughts manifesting hostility to arbitration, whatever their genesis. The only excepted areas are those where Congress (expressly, by fair implication, or by delegation) has itself exhibited a preference for some other forum or rule. See McMahon, 482 U.S. at 226-27; Kroog v. Mait, 712 F.2d 1148, 1154 n.5 (7th Cir. 1983), cert. denied, 465 U.S. 1007 (1984).

suggest, however, that this bespeaks no unfriendliness: the Commonwealth treats arbitration agreements like other contracts between businesses and consumers, that it, it regulates them as extensively as necessary for the public weal. In our view, that self-congratulatory casuistry will not wash. Indeed, we think it evident that it was precisly this sort of categorization error which Congress sought to cure when it enacted the FAA.

In creating a body of substantive law convering arbitration, Congress barred the states from making determinations about arbitration contracts that the states remained free to make about, say, used car sales. Perry, 482 U.S. at 492 n.9; McMahon, 482 U.S. at 226. Even if regulators find industry-wide practices that would be

grounds for voiding arbitration agreements at common law, e.g., fraud or coercion, any separate regulatory action or sanction singling out arbitration agreements from contracts generally would be preempted. PDAAs may be void on these grounds, exactly as would contracts of other types conceived fraudulently or in unduly coercive circumstances - no more, no less. The FAA prohibits a state from taking more stringent action addressed specifically, and limited, to arbitration contracts.

That is not to say that a state can do nothing about a perceived problem. The Commonwealth's powers remain great, so long as used evenhandedly. The FAA does not prohibit judicial relief from arbitration contracts which are shown to result from fraud or enormous (unfair)

economic imbalance of the sort sufficient to avoid contracts of all types.[5/] Rodriguez de Quijas, 109 S. Ct. at 1921. "Thus state law, whether of legislative or judicial origin, is applicable [and not preempted] if that law arose to govern issues concerning the validity, revocability, and enforceability of contracts generally." Perry, 482 U.S. 492 n.9 (emphasis in original). Massachusetts could also pass legislation declaring all contracts

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5/ Although any fraudulent, adhesive, or economically coerced agreement to arbitrate would be challengeable, the Supreme Court has suggested that such challenges must not only be brought on grounds common to contracts generally, but must also be proven on the facts of the individual case, not automatically shunted to one side according to practices governing the formation of arbitration agreements as a class of contracts. See Rodriguez de Quijas, 109 S.Ct. at 1921.

of adhesion presumptively unenforceable. See Rakoff, Contracts of Adhesion: An Essay in Reconstruction, 96 Harv. L. Rev. 1173, 1248 n. 239 (1983). Such a rule would apply to arbitration contracts, among others. But Massachusetts may not say (judicially, legislatively, or in a regulatory mode) that "adhesion contracts are especially bad when arbitration is included, so we will therefore ban, or place gyves and shackles upon, only those adhesive contracts which contain arbitration clauses." That kind of value judgment is foreclosed precisely because the FAA ordains that the state's appulse toward arbitration agreements must be the same as its approach to contracts generally. Perry, 482 U.S. at 492 n.9; McMahon, 482 U.S. at 226.

E

Appellants also urge us to find that, notwithstanding the general rule, Congress carved out an exception to the Act by permitting states concurrently to regulate securities transactions. We need not linger long over this asseveration. The Court has recently addressed the theoretical overlap between securities regulation and the FAA, holding that claims under section 12(2) of the Securities Act of 1933, 15 U.S.C. § 77l(2), could be the subjects of arbitration. Rodriguez de Quijas, 109 S. Ct. at 1922. The same holds true for claims arising under section 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. § 78j(b). McMahon, 482 U.S. at 227-28, 238. There, the Court noted

that "[w]hen Congress enacted the Exchange Act in 1934, it did not specifically address the question of the arbitrability of § 10(b) claims." Id. at 227. Congress's failure explicitly to resolve the potential conflict between the FAA and the 1933 and 1934 Acts has impelled the Court to determine the proper boundaries. In so doing, the Justices set forth an analytic framework which we find important to our inquiry.

Starting with the premise that the FAA was intended to have the full breadth apparent from its plain language, the Court noted that the 1934 Act "provides no basis for disfavoring agreements to arbitrate statutory claims by skewing the otherwise hospitable inquiry into arbitrability." McMahon, 482 U.S. at 226 (quoting Mitsubishi

Motors, 473 U.S. at 627); see also Rodriguez de Quijas, 109 S.Ct. at 1920-21. If claims actually based on a federal statute are not sacrosanct, then we can see no reason why ordinary contractual relations between customers and broker-dealers would not be accessible to the reach of the FAA. Such dealings strike us as well within the universe of possible topics "otherwise hospitable" to arbitration. As such, they are subject to the full force of the FAA's core command: that an arbitration contract be treated like "any contract." 9 U.S.C. § 2.

Simply put, nothing in the Securities Act, the Exchange Act, or the grant of concurrent power to the states to regulate securities manifests a congressional intent to limit or

prohibit waiver of a judicial forum for a particular claim, or to abridge the sweep of the FAA. Rodriguez de Quijas, 109 S.Ct. at 1920; McMahon, 482 U.S. at 226. And we are mindful that: "The burden is on the party opposing arbitration . . . to show that Congress intended to preclude a waiver of judicial remedies for the statutory rights at issue." McMahon, 482 U.S. at 226; see also Mitsubishi Motors, 473 U.S. at 628 (parties should be held to arbitral bargain "unless Congress itself has evinced an intention to preclude a waiver of judicial remedies for the statutory rights at issue"); Page v. Moseley, Hallgarten, Estabrook & Weeden, Inc., 806 F.2d 291, 295 (1st Cir. 1986)(court must "enforce the [arbitral] agreement unless . . . the Congressional

intent in enacting the [right-creating] statute was to preclude the waiver of judicial remedies")(emphasis in original). That burden has not been carried.

Nor are we willing to infer implicit congressional approval of the Commonwealth's policy simply because the Commodities Futures Trading Commission (CFTC) has adopted rules, see 17 C.F.R. § 180.3 (1988), not dissimilar in spirit from the Massachusetts regulations. The same holds true of recent Securities and Exchange Commission (SEC) activities, including the SEC's approval of rules submitted by three self-regulatory organizations requiring brokers to discuss customer's rights under mandatory arbitration agreements and to include language in arbitration clauses

informing customers that they are waiving judicial fora. See Order Approving Proposed Rule Changes, 54 Fed. Reg. 21,144 (1989). Both CFTC's rulemaking and the SEC's acquiescence are products of federal, not state, authority. That is a critical distinction. See McMahon, 482 U.S. at 226 (the "Act's mandate may be overridden by a contrary congressional command")(emphasis supplied); Felkner v. Dean Witter Reynolds, Inc., 800 F.2d 1466, 1468 n.3 (9th Cir. 1986). Congress has not structured a similar arbitration exception for securities in general and certainly not for state regulation of securities in particular. Kroog v. Mait, 712 F.2d 1148, 1154 n.5 (7th Cir. 1983), cert. denied, 465 U.S. 1007 (1984).

We go one extra step. If Congress meant to exempt the regulation of securities from the FAA's sphere of influence, "such an intent 'will be deducible from [the statute's] text or legislative history,' or from an inherent conflict between arbitration and the statute's underlying purpose." McMahon, 482 U.S. at 227 (citations omitted); accord Rodriguez de Quijas, 109 S.Ct. at 1920. There is nothing in the language of the Securities Act, the Exchange Act, or the pertinent legislative history, which points in such a direction. By the same token, appellants have utterly failed to demonstrate any inherent conflict or to suggest any valid reason why "arbitration is inadequate to protect the substantive rights at issue."

McMahon, 482 U.S. at 229. The opposite seems true: any remnants of Wilko's "outmoded presumption of disfavoring arbitration proceedings" have been laid to rest, once and for all. Rodriguez de Quijas, 109 S.Ct. at 1920.6/

The long and short of it is that we can find no evidence of a clear congressional command to override the unambiguous pro-arbitration mandate of the FAA in the securities field.

6/ McMahon adequately evinces the point. There, only a dissenter, not the Court's majority, felt that arbitration could fail to protect an investor's substantive rights. 482 U.S. at 257-66 (Blackmun, J., dissenting).

III

A

Ordinarily, our determination that the Regulations conflict with the requirement that arbitration contracts be treated on a par with contracts generally would end the matter. Here, however, there is a further wrinkle. On their face, the Regulations do not govern PDAAs at all. Rather, they purport to address broker-dealers who would require customers to sign PDAAs. This difference, appellants tell us, is determinative.

The dialectic is too clever by half. Even if we grant the claim that a contract made in the face of such an ethical order to a contracting party would be enforceable - a claim open to

considerable doubt, and upon which we express no opinion[7/] - the Regulations would still be preempted. Without recognizing it, appellants appear to have trapped themselves in a trick box.

7/ It is hornbook law that one who violates a licensing statute - which, as here, is not a revenue measure, but a public-protection statute - is generally not allowed to enforce the contract. The usual case arises where an unlicensed party performs services requiring a license. See, e.g., Shinberg v. Bruk, 875 F.2d 973, 976 (1st Cir. 1989)(attorney not licensed as real estate broker barred from claiming finder's fee). In this situation, however, the terms of the contract constitute the basis for the ethical proscription. Thus, the closer analogy would seem to be that if, "in making and performing [the contract] he defrauded the other party, the latter has a good defense . . . ." 6A A. Corbin, Corbin on Contracts, § 1510 (1962); see also J. Calamari & J. Perillo, Contracts § 22-7 (2d ed. 1977); Restatement (Second) of Contracts § 181 (1981). Moreover, as the district court pointed out, 703 F. Supp. at 149, Mass. Gen. L. ch. 110A, § 410(f) would likely prevent a broker from enforcing a contract made in violation of the Regulations.

As the district court noted and documented, unconscionability is the standard for voluntariness in Massachusetts. 703 F. Supp. at 152-53. Either the Regulations create a stricter standard for PDAAs, or they are functionally meaningless. If the former, then the Regulations, by requiring what is not generally required to enter contracts in the Commonwealth, e.g., certain negotiations, explanations, and disclosures, inhibit a party's willingness to create an arbitration contract or undermine the contract's enforceability (if the party proceeds notwithstanding the edict). By itself, such an ethical mandate is sufficient to lead us to rule that the Regulations go too far.

State law need not clash head on with a federal enactment in order to be preempted. If state law "stands as an obstacle to the accomplishment of the full purpose and objectives of Congress," it must topple. Schneidewind, 108 S. Ct. at 1151 (citations omitted); see also French, 869 F.2d at 7 (state statute preempted when "too discommoding" to federal scheme); Palmer, 825 F.2d at 629 (state tort liability preempted when enforcement would be "seriously disruptive to the congressionally calibrated balance of national interests"). In enacting the FAA, Congress evinced an unmistakable "federal policy favoring arbitration agreements," one which was to be applied liberally. Moses Cone, 460 U.S. at 24.

Court are to do so even where "state substantive or procedural policies" run to the contrary, always resolving "any doubts concerning the scope of arbitrable issues . . . in favor of arbitration." Id. at 24-25. Wherever there is "an allegation of waiver, delay, or a like defense to arbitrability," we must heed the underlying federal interest. Id. at 25. The lesson is entirely clear: "A state law principle that takes its meaning precisely from the fact that a contract to arbitrate is at issue does not comport with [the equality] requirement of § 2." Perry, 482 U.S. at 492 n.9.[8/] That is to say, courts

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8/ Technically, as appellants are quick to note, the statements of the Perry Court contained in footnote 9 of its opinion are dicta. But, we find them to be considered dicta, reflective of the applicable rule of law.

must follow congressional intent and "foreclose state legislative attempts to undercut the enforceability of arbitration agreements." Southland, 465 U.S. at 16. The legal standard is whether the Regulations take their meaning from the fact that a contract to arbitrate is at issue, or frustrate arbitration, or provide a defense to it. If so, the federal policy requires that we resolve all doubts in favor or arbitration, finding the Regulations preempted.

In this instance, we conclude as a matter of law that the Regulations actually conflict with the FAA and the federal policy embedded therein. The Regulations leave no room for speculation: it is unarguable from their wording that they derive their

essential meaning from the fact that a contract to arbitrate is at issue. As the district court noted, the Commonwealth's wistful assertion that the Regulations are not addressed to the validity and enforceability of PDAAs "can be maintained only by assuming that no provision of state law other than one directly governing contract validity or enforceability comes within the preemptive reach of the Arbitration Act." 703 F. Supp. at 156. That assumption is so seriously flawed that it cannot be countenanced.

The Regulations must also fall because they are at odds with the policy which infuses the FAA. The power to suspend a license is much more than a shift in costs; it is the economic equivalent of the death penalty. The

worry that requiring a PDAA might forfeit a firm's ability to function as a broker-dealer at all is an obstacle of greater proportions even than the chance that, in a given dispute, an arbitration agreement might be declared void. To the extent that the substantive state policy to foster "ethical" broker-dealers, embodied in the Regulations here at issue, conflicts with the federal policy to "favor[ ] arbitration agreements," Moses Cone, 460 U.S. at 24, it is preempted.

B

A policy designed to prevent one party from enforcing an arbitration contract or provision by visiting a penalty on that party is, without much

question, contrary to the policies of the FAA. But, there is at least one other way in which the Massachusetts policy would erode the goals of the Act. The Regulations are aimed at nonnegotiable "standard-form" PDAAs. Arbitration is a positive good in the eyes of the courts and Congress not just because it relieves crowded calendars, but because it relieves an often unnecessary elaboration of social practices. As the Court has stated, resort to arbitration "trades the procedures and opportunity for review of the courtroom for the simplicity, informaility, and expedition of arbitration." Mitsubishi Motors, 473 U.S. at 628. We must, therefore, be vagilant lest we recreate even the beginnings of hypertrophy in the

formation of arbitration contracts. The Regulations demand exactly the kind of inefficiency which arbitration and standard-from contracts (generally legitimate under Massachusetts law) are designed to minify.[9/] By depriving broker-dealers of the opportunity to employ form contracts, even were there no penalty attached to their use, Massachusetts has acted to undercut the policies of simplicity and expedition that characterize the arbitral alternative.

9/ The Court has not seen fit to question use of standard-form contracts in circumstances where parties having apparently unequal bargaining power have agreed to arbitrate. See, e.g., Rodriguez de Quijas, 109 S. Ct. at 1921; Southland, 465 U.S. at 4; see also Webb, 800 F.2d at 807 ("The use of a standard form contract between two parties of admittedly unequal bargaining power does not invalidate an otherwise valid contractual provision.").

IV

The Commonwealth may well be correct that PDAAs ought to be arrived at with greater negotiation and disclosure between broker-dealers and customers than currently takes place. That judgment, however, is not the Commonwealth's to make, at least in its current embodiment, for it singles out arbitration in an impermissible way. The states are forbidden from critical scrutiny expressed in a fashion which might mask historic hostility toward arbitration. Congress sought to avoid having that possibility come to fruition, choosing instead to emphasize and endorse arbitral efficiencies. That value judgment was within the congressional domain - and only

Congress, not the states, may create exceptions to it.

That is not to say, of course, that a state must permit broker-dealers to sail as close to the wind as their consciences (or lack thereof) might permit. Massachusetts has a plenitude of lawful weapons in its ethical armamentarium to preserve the integrity of the securities business as conducted in the Commonwealth and to protect consumers. Cf., e.g., Volt, 109 S. Ct. at 1254. But because the Regulations treat standard-form PDAAs in the securities industry more severly than standard-from contracts are generally treated under Massachusetts law, and because the policies underlying the Regulations, and their method of enforcement, conflict with the national

policy favoring arbitration, the state scheme is too discommoding to the federal plan. The Regulations are, therefore, preempted.

We need go no further.[10/] The judgment of the district court must be Affirmed.

10/ We do not address appellants' contention that the district court erred in denying their motion to defer brevis disposition pending further discovery. See Fed. R. Civ. P. 56(f). According to a supporting affidavit, appellants sought the delay to "assess the impact of the regulations on broker and customer behavior." The motion was not directed at discovery of any facts material to the legal question - whether the FAA preempts the Regulations - which we, like the lower court, have found determinative. Thus, the Rule 56(f) motion is, for our purposes, beside the point. See Paterson-Leitch Co. v. Massachusetts Municipal Wholesale Elec. Co., 840 F.2d 985, 988 (1st Cir. 1988) (to be effective, Rule 56(f) motion must show that facts likely exist which, if obtained, will "engender an issue both genuine and material").

APPENDIX

[to Decision of Court of Appeals]

12.204: Denial, Revocation, Suspension, Cancellation, and Withdrawal of Registration

[[a](1) through (a)(2)(F): Reserved]

[G] Dishonest or unethical practices in the securities business.

1. Broker-dealers. Each broker-dealer shall observe high standards of commercial honor and just and equitable principles of trade in the conduct of its business. Act[s] and practices, including but not limited to the following, are considered contrary to such standards and constitute dishonest or unethical practices which are grounds for denial, suspension or revocation of registration or such other action authorized by law:

a. Requiring on or after January 1, 1989, that a customer located in Massachusetts, other than a customer that is an institutional investor or financial institution specified in 950 CMR 14.401(e), execute either a mandatory pre-dispute arbitration contract or a customer agreement containing a mandatory pre-dispute arbitration clause that is a non-negotiable precondition to effecting transactions in securities for the account of the customer or opening a securities cash account or margin account by the customer with such broker-dealer;

b. Requesting on or after January 1, 1989, that a customer located in Massachusetts execute either a mandatory pre-dispute arbitration contract or a customer account agreement containing a pre-dispute arbitration clause where the contract or agreement fails to conspicuously disclose that the execution of the contract or agreement cannot be made a non-negotiable precondition to the opening by the customer of a securities account with the broker-dealer;

c. Requesting on or after January 1, 1989, that a customer located in Massachusetts execute either a mandatory pre-dispute arbitration

contract or a customer account agreement containing a pre-dispute arbitration clause without fully disclosing to the customer in writing the legal effect of the pre-dispute arbitration contract or clause;

d. Being found by a court of competent jurisdiction to have violated M.G.L. c. 93A in connection with the sale of securities; and

e. Being temporarily or permanently enjoined by any court of competent jurisdiction from violating M.G.L. c. 93A in connection with the sale of securities.

APPENDIX B

UNITED STATES COURT OF APPEALS
FOR THE FIRST CIRCUIT

No. 89-1022

SECURITIES INDUSTRY ASSOCIATION, et al.,
Plaintiffs, Appellees,

v.

MICHAEL J. CONNOLLY, ETC., et al.,

Defendants, Appellants.

JUDGMENT

ENTERED: AUGUST 31, 1989

This cause came on to be heard on appeal from the United States District Court for the District of Massachusetts, and was argued by counsel.

Upon consideration whereof, it is now here ordered, adjudged and decreed as follows: The judgment of the district court is affirmed.

By the Court,

/s/

Clerk

APPENDIX C

UNITED STATES DISTRICT COURT
DISTRICT OF MASSACHUSETTS

SECURITIES INDUSTRY ASSOCIATION,
DEAN WITTER REYNOLDS, INC.,
DONALDSON, LUFKIN & JENRETTE
SECURITIES CORPORATION,
DREXEL BURNHAM LAMBERT, INCORPORATED,
FIDELITY BROKERAGE SERVICES INC.,
KIDDER PEABODY & CO., INCORPORATED,
MERRILL LYNCH, PIERCE, FENNER &
SMITH, INC.,
PAINEWEBBER INCORPORATED,
PRUDENTIAL-BACHE SECURITIES INC.,
SHEARSON LEHMAN HUTTON INC., and
SMITH BARNEY, HARRIS UPHAM & CO.,
INCORPORATED,

Plaintiffs,

v.

MICHAEL J. CONNOLLY, Secretary of
State, and
BARRY C. GUTHARY, Director,
Massachusetts Securities Division,

Defendants.

MEMORANDUM AND ORDER FOR JUDGMENT

December 19, 1988

WOODLOCK, D.J.

The Commonwealth of Massachusetts, acting under its Blue Sky law authority over brokers and dealers in securities, has issued prospective regulations seeking to control the circumstances under which a broker may require a non-institutional customer located in Massachusetts to agree to arbitration of disputes between them.

The plaintiffs -- the trade association for securities dealers and ten brokerage firms registered to do business as securities broker-dealers in Massachusetts -- challenge these regulations on federal constitutional grounds, contending they are preempted by the Federal Arbitration Act, 9 U.S.C. § 1 et seq. The Act requires that in matters affecting the validity, revocability, and enforceability of

arbitration agreements, those agreements must be treated no differently than other contracts.

Without adopting any view on the advisability of such provisions, I find that the Massachusetts Blue Sky authorities are without power to enforce them. The Massachusetts securities arbitration regulations are not merely state law supplementation concerning matters collateral to the validity and enforceability of arbitration agreements. Rather, they go to the heart of the process of forming contracts to arbitrate. In doing so, they single out arbitration agreements for more demanding standards than are imposed by the general law of contracts in Massachusetts. Consequently, I will grant the plaintiffs' motion for summary judgment and declare the Massachusetts

securities arbitration regulations preempted by the Federal Arbitration Act.

I

In the wake of Shearson/American Express, Inc. v. McMahon, 107 S.Ct. 2332 (1987), in which the Supreme Court upheld the use of predispute arbitration clauses to govern resolution of controversies between brokers and their customers,[1/] officials of the Commonwealth of Massachusetts moved quickly to crest the tide of proposals

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1/ Strictly speaking, McMahon addressed arbitration of statutory securities law claims only under § 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. § 78j(b), and did not expressly overrule Wilko v. Swan, 346 U.S. 427 (1953), which had held that a predispute agreement could not be enforced to compel arbitration under § 12(2) of the Securities Act of 1933, 15 U.S.C.

(footnote continued)

to control the circumstances in which such arbitration could be used. While the North American Securities Administrators Association was calling for reform,[2/] while the United States

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(footnote continued)

§ 771(2). The expansive preemptive scope accorded the Federal Arbitration Act in McMahon, however, has placed the continued vitality of Wilko in doubt. A split has appeared in the circuits on the question. Compare Rodriquez De Quijas v. Shearson/Lehman Bros., Inc., 845 F.2d 1296 (5th Cir.)(McMahon effectively overruled Wilko), cert. granted, 57 U.S.L.W. 3347 (U.S. Nov. 15, 1988) (No. 88-385) with Chang v. Lin, 824 F.2d 219 (2d Cir. 1987) (Wilko remains good law in absence of express overruling by the Supreme Court). Presumably the Supreme Court's grant of the petition for certiorari in Rodriquez will resolve this question.

2/ NASAA, in a Briefing Paper entitled "Oversight of Securities Arbitration" (June 1988), reported that it had "unveiled in early June a detailed proposal for reform of securities arbitration." Id. at 6. NASAA also announced that it "is exploring the

(footnote continued)

Securities and Exchange Commission was seeking further study and encouraging rule making by the broker/dealer self-regulatory organizations,[3/]

(footnote continued)

possibility of developing model language for state laws or rules to govern mandatory arbitration clauses in written customer agreements." Id. In October 1988, after this litigation was commenced, NASAA adopted a "Resolution Concerning the Execution of Compulsory Pre-Dispute Arbitration Agreements as a Condition Precedent to Obtaining Brokerage Services," in which it expressed "support [for] the goals and policies of the Massachusetts rules as being consistent with NASAA's purpose of advancing the principle of investor protection and affording choice to investors in their decisions to participate in the securities markets." Second Affidavit of Barry C. Guthary, Exhibit A.

3/ In letters dated July 8, 1988, SEC Chairman David S. Ruder requested that all the self-regulatory organizations in the brokerage industry "review the issues raised by the current use of mandatory predispute arbitration agreements" and "report back to the commission by October 15, 1988."

(footnote continued)

while the United States Congress was failing to enact proposed legislation regarding securities dispute arbitration,[4/] the defendant Secretary of State of the Commonwealth of

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(footnote continued)

Statement of David S. Ruder Before the Subcomm. on Telecommunications and Finance of the House Comm. on Energy and Commerce Concerning the Securities Arbitration Process and the Voluntariness of Agreements to Arbitrate Broker-Dealer/Investor Disputes, July 12, 1988 [hereinafter Ruder Statement], Attachment 3. The proposals of the self-regulatory organizations have apparently been received and are under consideration by the Commission. See Wurczinger, SEC Faces Mandatory Arbitration Issue, Nat'l L.J., Nov. 14, 1988, at 21, col. 1.

4/ Legislation introduced by Congressmen Boucher, Dingell, and Markey, H.R. 4960, 100th Cong., 2d Sess. (June 30, 1988), see generally 134 Cong. Rec. E 2233 (remarks of Cong. Boucher); E 2239-41 (remarks of Cong. Dingell); E 2245-46 (remarks of Cong. Markey) (daily ed. June 30, 1988), died in Committee during the last Congress. 2 Congressional Index (CCH) at 35,106 (100th Cong.).

Massachusetts, through the defendant Director of the Massachusetts Securities Division, was taking definitive action.

The defendants' action came on September 21, 1988, in the form of a singular Massachusetts regulatory definition of "dishonest or unethical practices in the securities business" by broker-dealers. See Mass. Regs. Code tit. 950, § 12.204-(a)(2)(G)1.a.-c. 5/

5/ The new definition provides as follows:

(G) Dishonest or Unethical practices in the securities business.

1. Broker-dealers. Each broker-dealer shall observe high standards of commercial honor and just and equitable principles of trade in the conduct of its business. Act[s] and practices, including but not limited to the following, are considered contrary to such standards and constitute dishonest or unethical practices which are grounds for denial, suspension or revocation of registration or such other action authorized by law:

(footnote continued)

(footnote continued)

a. Requiring on or after January 1, 1989, that a customer located in Massachusetts, other than a customer that is an institutional investor or financial institution specified in 950 CMR 14.401(e), execute either a mandatory pre-dispute arbitration contract or a customer agreement containing a mandatory pre-dispute arbitration clause that is a non-negotiable precondition to effecting transactions in securities for the account of the customer or opening a securities cash account or margin account by the customer with such broker-dealer;

b. Requesting on or after January 1, 1989, that a customer located in Massachusetts execute either a mandatory pre-dispute arbitration contract or a customer account agreement containing a pre-dispute arbitration clause where the contract or agreement fails to conspicuously disclose that the execution of the contract or agreement cannot be made a non-negotiable precondition to the opening by the customer of a securities account with the broker-dealer;

c. Requesting on or after January 1, 1989, that a customer located in Massachusetts execute either a mandatory pre-dispute arbitration contract or a

This regulatory definition forbids broker-dealers licensed in Massachusetts from requiring Massachusetts customers to sign a mandatory pre-dispute arbitration agreement as a non-negotiable condition to opening a brokerage account. The definition also requires broker-dealers to disclose fully the legal effects of arbitration agreements before entering into a negotiated contract with a customer. What consitutes negotiability, and what full disclosure of legal effects would consist of, are left undefined by the definition.

(footnote continued)

customer account agreement containing a predispute arbitration clause without fully disclosing to the customer in writing the legal effect of the pre-dispute arbitration contract or clause;

. . . .

Under the Massachusetts securities arbitration regulations, non-negotiability of, and lack of full disclosure of legal effects regarding, arbitration agreements do not become dishonest or unethical until January 1, 1989.

Proscriptions against such "dishonest or unethical practices" by broker-dealers are enforced by the power of the defendant Secretary of State to deny, suspend, or revoke the registration of a broker or brokerage firm. Mass. Gen. L. ch. 110A, § 204. Because an unregistered broker may not transact business in Massachusetts, id. § 201, any broker who wishes to do business in Massachusetts must observe the securities arbitration contract regulations which the definition establishes.

Moreover, if a broker--or for that matter a customer--were to attempt to enforce a contract formed without compliance with the Massachusetts securities arbitration regulations, that attempt would be unavailing. Under Chapter 110A, § 410(f),

> [n]o person who has made or engaged in the performance of any contract in violation of any provision of this chapter or any rule or order hereunder, or who has acquired any purported right under any such contract with knowledge of the facts by reason of which its making or performance was in violation, may base any suit on the contract.

If implemented in January, these proscriptions will have an immediate effect on the contracts used by broker-dealers transacting business with customers located in Massachusetts. The affidavits submitted by the plaintiff brokerage firms indicate some variety in

their use of arbitration agreements, but certain elements are common.[6/] Mandatory written pre-dispute arbitration agreements in some form are used by all the plaintiffs. And these pre-dispute agreements do not purport to advise customers of the "legal effects" of the arbitration clauses.

6/ The written brokerage contracts in which these agreements are contained plainly concern transactions involving interstate and international commerce. For the most part, the purchase and sale of securities is conducted over national exchanges or through traders who are located in New York. The instrumentalities of interstate commerce -- telephones and the mails -- are used to execute and report brokerage trades. Thus, the agreements at issue here fall within the broad construction, see Societe Generale de Surveillance, S.A. v. Raytheon European Management and Systems Co., 643 F.2d 863, 867 (1st Cir. 1981), given the reach of the Federal Arbitration Act, which applies to any "written [arbitration] provision in . . . a contract evidencing a transaction involving commerce." 9 U.S.C. § 2.

Each of the plaintiff brokerage firms use arbitration agreements in its standard margin and option account contracts, with the exception of Shearson Lehman Hutton Inc., which has no arbitration clause in its option account contract. A bare majority of the plaintiffs, however, do not use arbitration accounts in standard cash accounts for individuals, although one member of that majority, Donaldson Lufkin & Jenrette Securities Corporation, does have an arbitration agreement for corporate customers. In addition, Smith Barney, Harris Upham & Co., which has an arbitration agreement in its standard cash account, avers that execution of that arbitration agreement

is not a requirement for opening a Smith Barney cash account.[7/]

The plaintiffs are unanimous in asserting a desire to require certain customers to agree to arbitrate disputes as a condition to opening an account.

7/ The plaintiffs' present practice appears to be fairly respresentative of the brokerage business generally. The Division of Market Regulation of the United States Securities and Exchange Commission in a 1987 study of the 65 firms which account for 90 percent of the brokerage customer trading accounts, see Ruder Statement, supra note 3, at 8, found that arbitration agreements were all but universal for margin accounts (89 percent of the firms used such agreements) and for option accounts (83 percent of the firms used such agreements). With respect to straight cash accounts, however, the percentage of total accounts using arbitration agreements is only about 40 percent. However, 30 percent of the firms surveyed in the SEC study reported that they had under active consideration plans to expand the number of accounts for which an arbitration agreement would be required. See SEC, Summary of Staff Findings with Respect to the Use of Predispute Arbitration Clauses, Ruder Statement, Attachment 4.

The Massachusetts securities arbitration regulations would change this practice by establishing additional disclosure requirements in an as yet undefined format. The Massachusetts securities arbitration regulations would also prevent broker-dealers from implementing the apparently universal practice of requiring at least certain customers to enter into arbitration agreements for their disputes.

II

In confronting a preemption claim, the "sole task" of the court is to determine the intent of Congress. Massachusetts Medical Soc'y v. Dukakis, 815 F.2d 790, 791 (1st Cir.), cert.

denied, 108 S.Ct. 229 (1987) (quoting California Fed. Sav. & Loan Ass'n v. Guerra, 479 U.S. 272, 280 (1987). The Federal Arbitration Act preempts the Massachusetts broker arbitration regulations "if and only if Congress intended it to do so." Id.

The question to be addressed is "whether Congress (expressly) did or (impliedly) meant to displace state law or state law concepts in enacting . . . the federal scheme set up by Congress." Palmer v. Liggett Group, Inc., 825 F.2d 620, 625-26 (1st. Cir. 1987). In answering that question, the principal consideration is whether state regulation creates a material disturbance in the field of federal concern. "If the state law disturbs too much the congressionally declared

scheme-whether denominated as 'occupying the field' or 'actually conflicting with federal law' -- it will be displaced through the force of preemption." Id. at 626.

The question whether the Massachusetts broker arbitration regulations at issue here materially disturb the federal arbitration scheme may be answered by reference to the history and the logic of the Arbitration Act.

-A-

At its enactment in 1925, the Act was intended to "revers[e] centuries of judicial hostility to arbitration agreements." Scherk v. Alberto-Culver Co., 417 U.S. 506, 510 (1974).

In 1953, the courts still harbored reservations about full applicability of the Arbitration Act. The decision that year in Wilko v. Swan, see supra note 1, "reflect[ed] a general suspicion of the desirability of arbitration and the competence of arbitral tribunals." Shearson/American Express, Inc. v. McMahon, 482 U.S. 220 (1987).

In the years after Wilko, however, the Supreme Court systematically rejected the reasons supporting Wilko's suspicion of the arbitration process. By 1987, the Supreme Court could observe that "the mistrust of arbitration that formed the basis for the Wilko opinion in 1953 is difficult to square with the assessment of arbitration that has prevailed since that time." Shearson, 482 U.S at 233.

Recent history has found the Supreme Court offering forceful endorsements of the arbitration process by expansive statements of the intent of Congress in passing the Federal Arbitration Act. In the last five years, the Court has variously found in the statute an embodiment of "Congress' intent to provide for the enforcement of arbitration agreements within the full reach of the Commerce Clause," Perry v. Thomas, 482 U.S. 483, 490 (1987); an "emphatic federal policy in favor or arbitral dispute resolution," Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc., 473 U.S. 614, 631 (1985); "a national policy favoring arbitration," Southland Corp. v. Keating, 465 U.S. 1, 10 (1984); and "a liberal federal policy favoring arbitration agreements,

notwithstanding any state substantive or procedural policies to the contrary," Moses H. Cone Memorial Hosp. v. Mercury Constr. Corp., 460 U.S. 1, 24 (1983).

That policy has been set loose with hydraulic pressure, sweeping away any state law purporting to "override the parties' choice to arbitrate rather than litigate in court." New England Energy Inc. v. Keystone Shipping Co., 855 F.2d 1, 4 (1st Cir. 1988). Of course, "the Federal Arbitration Act has never been construed to preempt all state law on arbitration." Id. Nevertheless, as the First Circuit recently observed in New England Energy, "the Supreme Court's decisions support a conclusion that all state laws seeking to limit the use of the arbitral process are superseded by

federal law." Id. (emphasis in original).

-B-

As a matter of logic, analysis of whether state regulations affecting the arbitration choice are preempted focuses on whether the state regulations "single out arbitration agreements" for special treatment. Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc., 723 F.2d 155, 158 (1st Cir. 1983), aff'd in part, rev'd in part, 473 U.S. 614 (1985). The anti-singularity premise has been articulated with both pedestrian and intestinal metaphors. Because the fundamental purpose of the Federal Arbitration Act "was to place an arbitration agreement 'upon the same footing as other contracts, where it

belongs'," Dean Witter Reylnolds, Inc. v. Byrd, 470 U.S. 213, 219 (1985) (quoting H.R. Rep. No. 96, 68th Cong., 1st Sess. 1 (1924)), the courts have been vigilant to ensure that state law concepts specially directed at arbitration contracts are not permitted to "eviscerate" that purpose, even indirectly. Southland Corp. v. Keating, 465 U.S. at 16 n.11; see, e.g., N&D Fashions, Inc. v. DHJ Indus., 548 F.2d 722, 727-28 (8th Cir. 1976); Medical Dev. Corp. v. Industrial Molding Corp., 479 F.2d 345, 348 (10th Cir. 1973); Michael v. NAP Consumer Elec. Corp., 574 F. Supp. 68, 70 (D.P.R. 1983) (Torruella, J.).

The formation of arbitration contracts can be wholly a matter of state law "if that law arose to govern

issues concerning the validity, revocability, and enforceability of contracts generally." Perry v. Thomas, 107 S.Ct. at 2527 n.9 (emphasis in original.) However, "[a] state law principle that takes its meaning precisely from the fact that a contract to arbitrate is at issue does not comport with [§2 of the Federal Arbitration Act]." Id. As a consequence, "§ 2 of the Act preempts state statutory and case law that treats arbitration agreements differently from any other contract." Cook Chocolate Co. v. Salomon, Inc., 684 F. Supp. 1177, 1182 (S.D.N.Y. 1988).

The metaphor of "equal footing" is expressly embodied in §2, which provides that written agreements "to settle by arbitration a controversy thereafter arising out of such contract . . . shall be valid, irrevocable, and enforceable,

save upon such grounds as exist at law or in equity for the revocation of any contract." (emphasis supplied.) The inherent logic of §2 was succinctly summarized by Judge Weinfeld in Avila Group, Inc. v. Norma J. of Cal., 426 F. Supp. 537, 541 (S.D.N.Y. 1983): "Courts applying federal law under the Arbitration Act have rejected cases that purport to apply special rules and requirements to agreements to arbitrate that are not applicable to other contracts" (footnote omitted).

III

The defendants concede that the regulations single out arbitration agreements: "It is true," defendants note in their Memorandum of Law on Summary Judgment, "that the regulations

themselves apply only to arbitration agreements." Id. at 46. In this sense, the defendants recognize that the securities arbitration regulations are the paradigm of "[a state law principle that takes its] meaning precisely from the fact that a contract to arbitrate is at issue." Id. at 46-47 (quoting Perry v. Thomas, 107 S.Ct. at 2527 n.9).

The defendants justify the regulations, however, by an appeal to another purpose evident in the legislative history of, and case law construing, the Federal Arbitration Act: the concern to implement voluntary agreements to arbitrate.[8/]

8/ The Supreme Court has characterized "[t]the preeminent concern of Congress in passing the Act [as]] enforce[ment of] private agreements into which parties ha[ve] entered." Dean Witter Reynolds, Inc. v. Byrd, 470 U.S. 213, 221 (1985).

Alternatively, they rely upon the overall pattern of securities broker regulations, which they contend has effectively modified the Arbitration Act so as to permit their regulations.

-A-

The defendants' appeal to the voluntariness concern of the Federal Arbitration Act is a semantic sleight of hand. There is no question that the Federal Arbitration Act was designed to give full force to the agreement of the parties--a presumptively voluntary undertaking. But, as used by the defendant, the concept of voluntariness addresses the fundamental principles of contract formation upon which questions of validity, revocability, and enforceability of arbitration agreements turn. As used in that way, the concept of voluntariness is not a matter subject

to idiosyncratic rules or definitions. Massachusetts is not free under the Federal Arbitration Act to develop a definition of voluntariness applicable only to the negotiation of arbitration agreements and not to other contracts generally.[9/]

9/ Federal courts have refused to apply similar state voluntariness enhancements specially directed toward arbitration agreements. The Eighth Circuit in Collins Radio Co. v. Ex-Cell-o Corp., 467 F.2d 995 (8th Cir. 1972), declined on preemption grounds to enforce a Texas law which allegedly required the advice and signature of a Texas attorney for each party to the arbitration agreement. In Webb v. R. Rowland & Co., 800 F.2d 803 (8th Cir. 1986), that court declined on preemption grounds to apply a choice of law provision in an arbitration agreement which would have invalidated the agreement for failure to provide a statutorily required special ten-point capital letter notice regarding the binding character of the arbitration provision and would possibly have rendered unenforceable as a contract of adhesion the preprinted arbitration form contract. And in Wydel

(footnote continued)

That, of course, is precisely what the defendants' purported voluntariness

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(footnote continued)

Associates v. Thermasol, Ltd., 452 F. Supp. 739 (W.D. Tex. 1978), Chief Judge Spears of the Western District of Texas refused to apply a provision of Texas' version of the Uniform Partnership Act to invalidate an arbitration agreement signed by only one of the partners.

The two cases cited by defendants as examples of singular state treatment of arbitration contract formation countenanced by the federal courts are, respectively, inapposite and nonpersuasive. In Hull v. Norcom, Inc., 750 F.2d 1547 (11th Cir. 1985), the court understood itself to be applying "the general provisions of state contract law to the determination of 'the making of [the] arbitration agreement'." Id. at 1551 (quoting 9 U.S.C. §4). Eassa Properties v. Shearson Lehman Bros. Inc., 851 F.2d 1301 (11th Cir. 1988), disposed of the issue by a brief footnote offering dicta. Finding that a single partner "had been vested with actual authority by the remaining partners to bind the partnership to the arbitration agreements," id. at 1305, the Court had no occasion to consider the effect of Perry and Wydel on its general observation that "state law governs the question of whether [an arbitration] agreement exists in the first instance," id. at 1304 n.7.

enhancements do. There is no general contractual duty in Massachusetts requiring one party to describe fully--or for that matter, at all--the legal effect of a contractual provision to another party with whom the first party proposes to contract.[10/]

10/ Indeed, as the Ninth Circuit noted recently:

> We know of no case holding that parties dealing at arm's length have a duty to explain to each other the terms of a written contract. We decline to impose such an obligation where the language of the contract clearly and explicitly provides for arbitration of disputes arising out of the contractual relationship.

Cohen v. Wedbush, Noble, Cooke, Inc., 841 F.2d 282, 287 (9th Cir. 1988); cf. Page v. Moseley, Hallgarten, Estabrook & Weeden, Inc., 806 F.2d 291, 295 n.6 (1st Cir. 1986) ("Despite . . . statement by the Wilko Court that certain investors may operate at a disadvantage vis a vis their more sophisticated brokers, we do not believe that it requires the invalidation of all customer-broker arbitration agreements ab initio") (emphasis in original).

Nor is there any general restriction requiring specific provisions to be "negotiable."[11/]

11/ Massachusetts follows the Restatement position that contracts of adhesion are not unenforceable unless they are unconscionable. See Zapatha v. Dairy Mart, Inc., 381 Mass. 284, 291-95 & 292 n.12, 408 N.E.2d 1370 (1980); Restatement (Second) of Contracts § 208 & comment d. Federal courts have consistently held that agreements to arbitrate are, as a matter of law, not unconscionable. See, e.g., Cohen v. Wedbush, Noble, Cooke, Inc., 841 F.2d at 286 (rejecting conclusion of California state courts that doctrine of unconscionability applies to standard securities arbitration contracts); Pierson v. Dean Witter Reynolds, Inc., 742 F.2d 334, 339 (7th Cir. 1984) (rejecting unconscionability claim in absence of showing that arbitration clause is commercially unreasonable or that plaintiffs lacked reasonable opportunity to understand it); Surman v. Merrill Lynch, Pierce, Fenner & Smith, 733 F.2d 59, 61 n.2 (8th Cir. 1984) (rejecting contention that standard brokerage agreement arbitration clauses are unconscionable); Hurlbut v. Gantshar, 674 F. Supp. 385, 392 (D. Mass. 1987) (holding that agreement to arbitrate securities brokerage disputes before independent, though industry-related, panel of arbitrators pursuant to standard form contract is not unconscionable).

Thus there can be no question that the new arbitration provisions represent a radical departure from the treatment of contracts generally in the State's common law. To be sure, Massachusetts law does contain a variety of idiosyncratic statutory provisions which require special treatment of--and disclosure regarding--certain types of contractual provisions. But the short and sufficient answer to this point is that these provisions-whether styled voluntariness enhancements or not--are the exception which prove the rule. For example, when Massachusetts wanted to require certain disclosures in the consumer credit context, a special truth-in-lending law, Mass. Gen. L. ch. 140D, was necessary, because the Act represented a significant departure from

the law which affects contracts generally in Massachusetts.[12/] And of course, neither the Massachusetts truth-in-lending provisions, nor any of the other exceptions cited by the defendants as authority, purports to single out arbitration agreements.

The Massachusetts securities arbitration regulations are not concerned with "matters collateral to

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12/ And even in those circumstances, statutory state law must not interfere with the broader federal scheme. Thus, under the Federal Truth in Lending Act, 15 U.S.C. § 1601 et seq., for example, inconsistent state disclosure requirements are preempted by the federal statute. See, e.g., Truth in Lending: Determinations of Effect on Mississippi, New Jersey, Oklahoma, and South Carolina State Laws, 48 Fed. Reg. 43,672 (1983); Mason v. General Finance Corp. of Va., 542 F.2d 1226 (4th Cir. 1976); Trustees Loan & Discount Co. v. Carswell, 435 So.2d 114 (Ala. Civ. App. 1983); Public Finance Corp. v. Riddle, 83 Ill. App.3d 417, 403 N.E.2d 1316 (1980).

the agreement to arbitrate," such as the procedural issues relating to consolidation of arbitration proceedings dealt with by the First Circuit in New England Energy Inc. v. Keystone Shipping Co., 855 F.2d 1, 4 n.2 (1st Cir. 1988). Rather, the defendants' regulations govern the validity and enforceability of arbitration agreements themselves by establishing standards which, if not met, render the arbitration agreements unenforceable and the unsuccessful makers of those agreements subject to sanction. It is difficult to imagine regulation more central to the arbitral decision.

The defendants' regulations assume this central position by establishing hurdles to the formation and execution of securities arbitration agreements

that are not found in the general contract law of Massachusetts. Because the voluntariness concerns expressed in the unique Massachusetts securities arbitration regulations impose conditions on the formation and execution of arbitration agreements which are not part of the generally applicable contract law of Massachusetts, they cannot be given effect under the Federal Arbitration Act.

-B-

But analysis does not stop with the Arbitration Act alone. As the Supreme Court observed in McMahon:

> Like any statutory directive, the Arbitration Act's mandate may be overridden by a contrary congressional command. The burden is on the party opposing arbitration, however, to show that

> Congress intended to preclude a waiver of judicial remedies for the statutory rights at issue.

107 S.Ct. at 2337.

Defendants suggest that the role of state Blue Sky law in securities regulation as expressed in the various savings clauses of the federal securities statutes[13/] provides that contrary command. This argument finds no support in the case law.

The Seventh Circuit in Kroog v. Mait, 712 F.2d 1148 (7th Cir. 1983), cert. denied, 465 U.S. 1007 (1984), rejected the proposition that general savings language which permits concurrent state and federal regulation

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13/ See, e.g., 15 U.S.C. § 77r (1933 Act); 15 U.S.C. § 78bb(a) (1934 Act); 15 U.S.C. § 80b-18a (Investment Advisers Act of 1940).

of the securities business could sustain a special treatment of arbitration agreements under Wisconsin Blue Sky law. In Kroog, the court declined to indulge a Wisconsin effort to import special arbitration regulation under cover of Blue Sky law. The court found that there was no conflict between Congressional protection of state securities regulation through the savings clauses and the federal law of arbitrability maintained under the Federal Arbitration Act:

> [T]he conflict we face is plainly not one of federal arbitration procedures versus Wisconsin substantive securities regulation. The conflict is rather between two procedural demands--one that commands, and the other that prohibits, the arbitration of brokerage contract claims. If the Arbitration Act prevails, Wisconsin substantive securities law remains intact, and would indeed have to be considered by the arbitrator of the dispute here.

Id. at 1153 (emphasis in original).

Needless to say, the Federal Arbitration Act prevailed in Kroog. Thus, even giving full scope to the appropriate role of state Blue Sky law, the savings provisions of the various federal securities statutes do not provide a "contrary Congressional command" permitting state Blue Sky regulators to establish special conditions applicable to arbitration contracts in derogation of the directions of the Federal Arbitration Act. Cf. Osterneck v. Merrill Lynch, Pierce, Ferner & Smith, Inc., 841 F.2d 508, 512 (3d Cir. 1988) (holding preempted § 507 of the Pennsylvania Securities Act when applied to preclude arbitration that falls within the FAA because "[t]he overwhelming weight of precedent militates against . . .

finding that Congress intended to exempt state securities claims from the general command of the [FAA]").

The defendants point to the treatment given arbitrability by the District of Columbia Blue Sky provisions as authority for the Massachusetts arbitration regulations. See Levin v. Dean Witter Reynolds, Inc., 3 Blue Sky L. Rep. (CCH) ¶ 71,812 (D.D.C. 1983). But Levin rested on a Congressional enactment concerned with the District of Columbia as a federal enclave. This provided Congressional authorization for the District's Blue Sky regulation separate from the savings clauses. Thus, the question in Levin was not whether a state legislature could create a Wilko-type exception to §2 of the Arbitration Act, but rather whether

Congress, in enacting the District of Columbia Blue Sky provisions, had done so. Cf. Southland Corp. v. Keating, 465 U.S. at 16 n.11. At issue in Levin was a specific Congressional anti-waiver provision of the type the Supreme Court had found sufficient to override the Arbitration Act in Wilko v. Swan, 346 U.S. 427 (1953). Massachusetts Blue Sky law, however, is not supported by such an independent Congressional enactment.[14/]

14/ For the same reason, the authority granted by Congress to the Commodities Futures Trading Commission to regulate predispute arbitration agreements involving commodities futures, see 17 C.F.R. pt. 180; see generally Ingbar v. Drexel Burnham Lambert Inc., 683 F.2d 603 (1st Cir. 1982), is inapposite. Nothing in that separate authority suggests that Congress has empowered Massachusetts to create similar regulations to govern predispute arbitration agreements for securities disputes.

Moreover, taking a broader view of the authority of securities regulators to address arbitration agreements, it is uncertain whether Wilko itself remains authoritative even on its limited facts. See supra note 1. It is clear that the Supreme Court has had second thoughts about the role of anti-waiver provisions of the type used in Wilko and Levin to override the Federal Arbitration Act.

In part, the careful restriction of Wilko to its specific facts, see Shearson/American Express, Inc. v. McMahon, 107 S.Ct. 2332 (1987), and the pending reconsideration of the narrowed holding itself, see Rodriguez de Quijas v. Shearson/Leahman Bros., Inc., 845 F.2d 1296 (5th Cir.), cert. granted, 57 U.S.L.W. 3347 (U.S. Nov. 15, 1988) (No.

88-385), appear to be premised on supervening Congressional action regarding the arbitrability of securities law claims. As the Supreme Court noted in McMahon, "[s]ince the 1975 amendments to §19 of the Exchange Act [15 U.S.C. §78s, the United States Securities and Exchange] Commission has had expansive power to ensure the adequacy of the arbitration procedures employed by [the national securities exchange and registered securities associations]." 107 S.Ct. at 2341. The Commission is now treading gingerly in this area and is encouraging rulemaking by the affected self-regulatory organizations. See supra note 3.[15/]

15/ Recognizing the limited vitality of Wilko v. Swan after McMahon, the SEC itself has actually withdrawn the

(footnote continued)

Especially given what the Ninth Circuit recently observed is the "virtually plenary authority [of the SEC] over the arbitration procedures adopted by the national securities exchanges and securities association," Cohen v. Wedbush, Noble, Cooke, Inc., 841 F.2d at 286, there is nothing in the pattern

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(footnote continued)

mandatory disclosure regulations it had earlier required in connection with securities arbitration agreements. Barely three months after the Supreme Court handed down McMahon, the Commission reversed its previous rulemaking proceeding, see Recourse to the Courts Notwithstanding Arbitration Clauses in Broker-Dealer Customer Agreements, 48 Fed. Reg. 53,404 (1983), and determined that a regulation requiring disclosure of the inapplicability of arbitration agreements to federal securities law claims, 17 C.F.R. § 240.15c2-2, was "no longer appropriate or accurate and, accordingly, should be rescinded." Rescission of Rule Governing Use of Predispute Arbitration Clauses in Broker-Dealer Customer Agreements, [1987 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 84,163 (Oct. 15, 1987).

of Congressional enactments regarding securities regulation which can fairly be read to contemplate a peculiar Massachusetts rule in the regulation of written arbitration agreements concerning the purchase and sale of securities in interstate commerce.[16/]

16/ The SEC declined an invitation I extended to file an amicus brief in this case on grounds that "the underlying preemption claim is based on the Federal Arbitration Act, not the federal securities laws." Letter of SEC General Counsel Daniel L. Goelzer to the Court (Nov. 14, 1988). The stated reason appears less than candid in light of the defendants' reliance on federal securities law for its opposition to the motion for summary judgment. I recognize, however, that various prudential and strategic considerations, including an interest in permitting the case law to ripen and a desire not to become committed even indirectly on an issue as yet unresolved within the agency, may govern the decision whether to file an amicus brief. Cf. P. Irons, The New Deal Lawyers 4-5 (1982). I draw no inferences one way or the other from the lack of a formal expression of the SEC's position on the issues presented to me by this case.

IV

The defendants seek to avoid definitive resolution of this action before the January 1, 1989 effective date for the arbitration regulations. They do so by interposing a motion under Fed. Civ. P. 56(f) requesting further discovery before the plaintiffs' summary judgment motion is resolved.

To be sure, the First Circuit has been careful to note that in looking to the effect the allegedly preemptive state action "will have on the federal scheme set up by Congress," courts must require that "[t]he harm of the state law on the federal scheme . . . be actual, not potential." Palmer v. Liggett Group, 825 F.2d at 626 & n.11.

But nothing in Palmer, or the line of cases it represents, provides justification for delay in entering

summary judgment for the defendants. The grounds for preemption are as apparent here as they were in Palmer. The actual harm inflicted on the federal scheme for arbitration by the Massachusetts securities arbitration regulations is manifest in the conditions they impose on the validity and enforceability of securities dispute arbitration agreements, conditions not generally applicable to contracts in the Commonwealth. No further factual development is necessary to deal with the legal consequences of that circumstance.

In pressing this motion, the defendants have adopted seemingly inconsistent official positions. After conducting what they presumably consider sufficient proceedings to have a

rational basis for promulgating the Massachusetts securities arbitration rules, the defendants now pose as incapable of demonstrating facts sufficient to defeat the plaintiffs' motion because the effect of the regulations is alleged by them to be in dispute. Given this purported inability to join issue with plaintiffs' motion, the defendant contend that no further action on their regulations--now that they have put them in place--should be taken until additional inquiry--which the defendants themselves did not feel obliged to undertake before promulgating the regulations--has been completed.

The defendants' position is laid out in a highly artificial manner. As a matter of semantics, they contend that the regulations are not addressed to the

validity or enforceability of arbitration contracts. This contention can be maintained only by assuming that no provision of the state law other than one directly governing contract validity or enforceability comes within the preemptive reach of the Arbitration Act. But, as Palmer suggests, indirect regulation through a system of sanctions can be every bit as "potent [a] method of governing conduct and controlling policy" as direct proscriptions regarding arbitration. Cf. id. at 627-28 (quoting San Diego Bldg. Trades Council v. Garmon, 359 U.S. 236, 247 (1959)). Justice Holmes, while sitting on the Massachusetts Supreme Judicial Court, described the system of sanctions as the essence of the law. "If you want to know the law and nothing else, you

must look at it as a bad man, who cares only for the material consequences which such knowledge enables him to predict . . . . " O.W. Holmes, The Path of the Law, in Collected Legal Papers 167, 171 (1920).

The material consequences are plain here. Should a securities broker attempt to deal with arbitration agreements in Massachusetts after January 1, 1989, in the manner applicable to Massachusetts contracts generally, she will find herself labelled "dishonest" and "unethical" and have her license to do business put in jeopardy. Indeed, as noted above, a contract in violation of the Massachusetts securites arbitration regulations is, as a matter of Massachusetts Blue Sky law,

unenforceable. Mass. Gen. L. ch. 110A, § 410(f). Massachusetts could not have been clearer in its intention--despite its oblique means of execution--to make securities arbitration contracts subject to different rules regarding validity and enforceability from those that govern other contracts. It takes no further factual development to reach that conclusion.

The specific additional discovery defendants seek does not appear to address any genuine issues of material fact. The defendant Guthary in his Third Affidavit submitted in support of the defendants' Rule 56(f) motion seek to develop additional information on "the marginal impact of the arbitration regulations on individualization [of customer accounts]," ¶ 4; whether "a

two-tiered commission scheme" to reflect different costs of pre-dispute and non-predispute arbitration contracts "could be implemented in ordinary compliance and training materials," ¶ 5; "the degree to which negotiation over arbitration clauses currently impairs broker-customer relationships," ¶ 6; "how often securities customers who do not sign arbitration agreements currently choose arbitration over litigation in the absence of a pre-dispute agreement," ¶ 8; and "the application of plaintiffs' commodities experience to securities" and "how many commodities customers arbitrate even in the absence of a pre-dispute arbitration agreement," ¶ 9.

None of these areas of inquiry--even if likely to produce some genuine

dispute, a matter defendants do not address--concerns any issues material to my determination. Thus defendants' motion pursuant to Rule 56(f) will be denied. See generally Paterson-Leitch Co. v. Massachusetts Mun. Wholesale Elec. Co., 840 F. 2d 985, 988-89 (1st Cir. 1988); Taylor v. Gallagher, 737 F.2d 134, 137 (1st Cir. 1984).

V.

Although I am prepared to grant plaintiffs' motion for summary judgment in this matter as a predicate to entry of the dispositive order, an excess of caution prompts me to offer in the alternative reasons for entering an interim order of preliminary injunction invalidating the Massachusetts securities arbitration regulations, should entry of summary judgment be

ruled premature because of the denial of defendants' Rule 56(f) motion.

In response to my scheduling conference observation that denial of the motion for summary judgment would not constitute a final order permitting appeal, plaintiffs filed a motion for a preliminary injunction in order to have a serviceable back-up vehicle for immediate appeal. If called upon to rule in this matter only on an interim basis, I would grant such a motion, as plainly satisfying the traditional four-pronged inquiry necessary to support a summary judgment determination in the First Circuit. See generally Planned Parenthood League of Mass. v. Bellotti, 641 F.2d 1006, 1009 (1st Cir. 1981).

A. Success on the Merits

My treatment of the motion for summary judgment makes clear my views regarding the plaintiffs' all but certain success on the merits. To the degree that additional positive findings of an adverse effect on arbitration are necessary, the materials presented by the plaintiffs in support of their summary judgment motion supply such additional evidence.

The experience of certain of the plaintiffs with commodities accounts, for which pre-dispute arbitration agreements are subject to special disclosure rules and may not be made a condition of doing business, indicates that a significant number of commodity accounts customers decline to enter into such agreements. In the experience of

plaintiff Shearson Lehman Hutton, 34 percent fewer commodities customers execute pre-dispute arbitration agreements than do securities customers. Affidavit of Theodore A. Krebsbach ¶ 9. A random survey by plaintiff PaineWebber found that 58 percent of commodities account customers refuse arbitration under the non-mandatory scheme. Affidavit of John A. Borgese ¶ 3.

To the degree that the Massachusetts securities arbitration regulations are modelled on the CFTC arbitration regulation, 17 C.F.R. pt. 180,[17/]

17/ It should be noted that the CFTC regulations are significantly more precise than the Massachusetts rules. The required disclosure is set forth in the CFTC regulations expressly. 17 C.F.R. § 180.3(b)(4)-(6). And rather than requiring negotiability, the CFTC regulations do not permit a pre-dispute arbitration agreement to be a condition of opening a commodities account. 17 C.F.R. § 180.3(b)(1).

the affidavits submitted in support of a preliminary injunction demonstrate that the special Massachusetts securities arbitration contract rules will have a limiting effect on the formation of arbitration agreements.

B. Harm to Plaintiffs

The harm to the plaintiffs is irreparable if enforcement of the regulation is not enjoined. The patterns and practices of contract formation regarding securities arbitration will, or course, need costly revision during the pendency of the litigation in the absence of an injunction. More significantly, the evidence demonstrates that the costs of dispute resolution itself will increase

in direct proportion to the number of claims in which arbitration is rejected. These are costs which cannot be recovered from the defendant state officials. Cf. National Tank Truck Carriers, Inc. v. Burke, 608 F.2d 819, 824 (1st Cir. 1979).

Moreover, they are substantial costs. A report prepared by Deloitte Haskins & Sells for the New York Stock Exchange indicates that on average the legal costs to brokerage firms from arbitration are $12,000 less than the legal costs for litigation in court. Affidavit of Paul J. Dubow ¶ 11. In the aggregate, while the extent of the plaintiffs' monetary loss is difficult if not impossible to calculate with any precision, it appears reasonable to assume that imposition of the

Massachusetts securities arbitration regulations will add between one-quarter to one-half million dollars annually to the legal fees of certain of the plaintiffs.

C. Harm to Defendants

The harm to the defendants if their regulations are suspended before this litigation reaches conclusion is modest and highly speculative at best. The defendants are in the peculiar posture of defending a set of regulations the effect of which they contend (by their Fed. R. Civ. P. 56(f) submissions) they are not now in a position to describe by admissible evidence. If additional evidence is necessary to demonstrate the interference of these regulations with

the Federal Arbitration Act - - a proposition I do not accept but which the defendants forward - - then a further period of time during which the impact of the singular Massachusetts securities arbitration regulations is studied and analyzed through discovery and full trial would cause little harm. That is the general approach taken by the Securities and Exchange Commission, see supra note 3, the federal agency the Courts recognize as having virtual plenary power to govern the arbitration contracts of brokers, see Cohen v. Wedbush, Noble, Cooke, Inc. 841 F.2d at 286.

The reasons adduced by the plaintiffs for special securities arbitration rules do not demonstrate that there will be any significant harm

if the rules are held in suspension pending a definitive determination of the merits of this case. The suggestion that litigation over the unconscionability of mandatory pre-dispute arbitration agreements will be reduced is hardly persuasive. The law that such agreements are not unconscionable per se is so consistent that a contention that they are should not require any court to linger long over the issue in any event.

To be sure, disclosure as a general proposition is difficult to fault. Certainly, full and fair disclosure is the zeitgeist of securities regulation. A case can be made that the fuller the disclosure the better. But the defendants have not undertaken to describe with particularly what precise

disclosure is necessary. Unlike the CFTC disclosure requirements, see supra note 17, the Massachusetts securities arbitration regulations give no direction about what full disclosure of the "legal effects" of pre-dispute arbitration agreements will entail. The disclosure concerns of the defendants have not been crystallized. In the unformed state in which they are presented by the Massachusetts securities arbitration regulations, these generalized concerns for disclosure do not lend immediacy to the speculative claim of harm to the defendants if interim injunctive relief is granted.

The defendants' interest in "negotiability" is no more compelling as a basis for finding injunctive harm.

The defendants speak broadly of unidentified benefits and inducements that brokers will be encouraged to offer to secure pre-dispute arbitration agreements with customers. To the degree these benefits and inducements are specified, however, they seem to center around commission rates. This potential impact on commission rates involves a secondary effect of the Massachusetts securities arbitration regulations which, far from suggesting harm to the defendants, raises troubling questions about the anticipated regulatory scope of defendants' treatment of arbitration by brokers and their customers.

The defendant Guthary, while professing to believe that the effect of his regulations on the plaintiffs'

business as evidenced in plaintiffs' affidavits is "speculative, without substantive factual support," offers his own "opinion [that] it would be practical for brokers to adopt a two-tiered commission scheme" to compensate for the cost differential between arbitrable customer accounts and those which are not. Third Affidavit of Barry C. Guthary ¶¶ 2, 5. This reference to the influence the Massachusetts securities arbitration regulations will have on commission rate structure suggests insinuation by local Blue Sky authorities into brokerage commission rate making, an area in which the SEC exercises full authority. See generally 17 C.F.R. § 240.19b-3; Adoption of Securities Exchange Act Rule 19b-3, Exchange Act Release No. 11,203,

[1974-75 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 80,067, at 84,955-57 (Jan. 23, 1975).

Moreover, it is by no means clear that such a two-tiered rate structure will be of economic benefit to customers. To the degree that arbitration consitutes a more economical form of dispute resolution, it may be anticipated that regulations which discourage arbitration will have the effect of raising commission rates - - at least on non-arbitration contracts - - to absorb the costs.[18/] It is

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18/ Of course, to the degree that individual brokerage firms perceive a demand for non-arbitration customer agreements, it may also be assumed that such agreements will be offered--and priced accordingly--by some brokers irrespective of whether state regulations encourage such agreements or not.

difficult to conceive what harm there will be to defendants if an interim injunction prevents (at least until completion of this litigation) institution of the "two-tier commission scheme" contemplated by defendants.

D. Public Interest

With respect to the question of the public interest, the Congress and the Supreme Court have offered the definitive word. In enforcing the "emphatic federal policy in favor of arbitral dispute resolution" implemented by the Federal Arbitration Act, Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc., 473 U.S. at 631, the Supreme Court described the benefits of arbitration favorably in the

antitrust context:

> [A]daptablility and access to expertise are hallmarks of arbitration. The anticipated subject matter of the dispute may be taken into account when the arbitrators are appointed, and arbitral rules typically provide for the participation of experts either employed by the parties or appointed by the tribunal. Moreover, it is often a judgment that streamlined proceedings and expeditious results will best serve their needs that causes parties to agree to arbitrate their disputes; it is typically a desire to keep the effort and expense required to resolve a dispute within manageable bounds that prompts them mutually to forgo access to judicial remedies.

Id. at 633 (footnote omitted.)

This is a form of dispute resolution Congress intended to facilitate in the securities context as well, where the Supreme Court has recently held that "agreements to arbitrate Exchange Act claims [are] 'enforce[able] . . . in

accord with the explicit provisions of the Arbitration Act'." McMahon, 107 S.Ct at 2343 (quoting Scherk v. Alberto-Culver Co., 417 U.S at 520).

The evidence adduced in plaintiffs' affidavits in support of a preliminary injunction tends to show that arbitration is a benefit both to public customers and to brokers like plaintiffs. Customer legal expenses are likely to mirror broker legal expenses; the finding of the Deloitte Haskins & Sells study that broker-dealer legal expenses are significantly less in arbitration than in court litigation may accordingly also be interpreted as predicting relative economic benefit favoring arbitration for the customer.

The Deloitte study shows that customers receive on average a significantly higher percentage of their original claims by pursuing their disputes in arbitration (19.57 percent of claim recovered) then in court litigation (2.60 percent of claim recovered). Affidavit of Paul J. Dubow ¶ 11. The plaintiff Dean Witter reports an even more favorable recovery for customer claimants who pursued arbitration in cases completed in 1987; for those Dean Witter claimants, arbitration yielded 37 percent of total compensatory damages sought, compared with 17.02 percent of such damages for those pursuing litigation. Id. ¶ 12.

In short, on the evidence before me it appears that court litigation affords customers the opportunity to pay more in

legal costs to get less in recovery. Moreover, this opportunity will apparently be preserved only after paying for brokerage services at the higher level of the "two-tiered commission scheme" the defendant Guthary opines will be the likely industry response to the Massachusetts securities arbitration regulations.

Finally, it should be noted that shifting securities disputes from arbitration to court litigation will bring these disputes to a federal court system already overburdened by a heavy caseload. It is a rare securities claim which cannot be styled as a federal question under § 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. § 78j(b), 17 C.F.R. § 240.10b-5. Such a case can be brought in the federal

courts without regard to the amount in controversy under 28 U.S.C. § 1337 and 15 U.S.C. § 78aa. It would be ironic - - and hardly in furtherance of the public interest in efficient federal courts - - if such actions by non-institutional customers were now to come into federal court in greater numbers at precisely the time that Congress has moved to limit smaller claims in federal court litigation by raising to $50,000 the amount in controversy minimum for diversity action. Judicial Improvements and Access to Justice Act, Pub. L. No. 100-702, § 201, 102 Stat. 4642 (1988) (to be codified at 28 U.S.C. § 1332).

On the evidence before me, I find significant functional benefits to the public generally, and to the structuring

of efficient and economic dispute resolution, if the likely limits on securities dispute arbitration proposed through the Massachusetts securities arbitration regulations are deferred pending conclusion of this case on the merits.

E. Conclusion

Evaluating these four prongs to preliminary injunction analysis inter se, I conclude that given the plaintiffs' clear likelihood of ultimate success on the merits of their preemption claim, the prospect of substantial irreparable harm to the plaintiffs if the injunction is not granted--as balanced against the potential for minimal harm to the

defendants if the injunction is granted--and the public interest on the part of both customers as a class and the public at large in furthering the emphatic national policy in favor of the efficiencies of arbitral dispute resolution, an interim injunction staying implementation of the Massachusetts securities arbitration regulations until conclusion of this litigation would be appropriate.

VI

I fully recognize the importance of permitting states to experiment with reform in economic regulation. Federal courts must be reticent about interposing their powers to prevent such experimentation. The principles were

stated with plain spoken eloquence by Justice Brandeis:

> To stay experimentation in things social and economic is a grave responsibility. Denial of the right to experiment may be fraught with serious consequences to the Nation. It is one of the happy incidents of the federal system that a single courageous state may, if its citizens choose, serve as a laboratory; and try novel social and economic experiments without risk to the rest of the country.

New State Ice Co. v. Liebmann, 285 U.S. 262, 311 (1932) (Brandeis, J., dissenting).

This reticence has been given expression by the First Circuit in the preemption context. The court has noted that the federal courts have an obligation to control preemption doctrine for two basic reasons rooted in principles of federalism and separation

of powers fundamental to our system of government. First, "diffusion of power to the states is said to further democracy," and second, "a finding of no preemption is regarded as preferable because Congress can overrule it by appropriate legislation, while a finding of preemption cannot be changed by the states." Agency Rent-A-Car, Inc. v. Connolly, 686 F.2d 1029, 1038 (1st Cir. 1982).

The key, however, is Congress--and here, the agency Congress has selected for supervision of securities arbitration: the United States Securities and Exchange Commission. Where Congress has been heard to have spoken as emphatically as it has been heard by the Supreme Court concerning the broad preemptive intent of the

Federal Arbitration Act in the area of securities disputes, any modification of that intent must come from Congress itself. The courts cannot evade the principles established by broadly preemptive legislation in order to permit state experimentation. Until Congress establishes exceptions to the Federal Arbitration Act permitting states to adopt singular legal principles for the formation and execution of arbitration agreements, state law provisions like the Massachusetts securities arbitration regulations cannot stand.

Finding that the Massachusetts securities arbitration regulations disturb too much the Congressionally declared scheme of treating the formation, validity, and enforceability

of arbitration contracts in the same manner as contracts generally, I conclude that I must order the Massachusetts securities arbitration regulations displaced by the force of preemption and allow the plaintiffs' motion for summary judgment.

Accordingly, it is hereby ORDERED that a judgment enter

1. declaring that the Massachusetts securities arbitration regulations, Mass. Reg. Code tit. 950, § 12:204(a)(2)(G)1.a.-c. are preempted by the Federal Arbitration Act, 9 U.S.C. § 1 et seq.; and

2. enjoining the defendants from enforcing the Massachusetts securities arbitration regulations in any manner.

Douglas P. Woodlock
United States District Judge

APPENDIX D

UNITED STATES DISTRICT COURT
DISTRICT OF MASSACHUSETTS

CIVIL ACTION NO. 88-2153-WD

SECURITIES INDUSTRY ASSOCIATION, et al.,

Plaintiffs,

v.

MICHAEL J. CONNOLLY, Secretary of State, et al.,

Defendants.

JUDGMENT

December 19, 1988

In accordance with the Memorandum and Order for Judgment issued this day,

it is hereby ORDERED, ADJUDGED and DECREED

1. That the Massachusetts securities arbitration regulations, Mass. Reg. Code tit. 950, § 12:204(a)(2)(G)1.a.-c., are violative of the Supremacy Clause of the Constitution of the United States, art. VI, cl. 2, in that they are preempted by the Federal Arbitration Act, 9 U.S.C. § 1 et seq., and

2. That the defendants shall refrain from enforcing the Massachusetts securities arbitration regulations in any manner.

/s/
Douglas P. Woodlock
United States District Judge